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BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON, D.C. 20268-0001

COMPLAINT OF GAMEFLY, INC.	Docket No. C2009-1

INITIAL BRIEF OF THE UNITED STATES POSTAL SERVICE

Respectfully submitted,

UNITED STATES POSTAL SERVICE

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STATEMENT OF THE CASE

GameFly Inc. rents DVDs containing computer games. It distributes its products primarily by mailing them to its customers using First-Class Mail flats rates. Netflix, Inc. rents movies and other video content, also recorded on DVDs. It distributes its products primarily by mailing them to its customers using First-Class Mail letter rates. Blockbuster, Inc. also rents movies recorded on DVDs, and has recently begun renting DVD games. Blockbuster's distribution relies on a combination of retail outlets and mailing. Blockbuster also mails discs at First-Class Mail letter rates.

GameFly initiated this Complaint in April of 2009 to challenge the Postal Service's operations policies and practices involved in processing and delivering DVDs. The Complaint capped efforts by GameFly over approximately two years to persuade the Postal Service to provide it with lower rates for mailing its DVDs. GameFly's objectives in these efforts varied, from suggesting that the Postal Service create a niche classification that would provide a lower rate than GameFly currently pays, to asking the Postal Service to waive the second ounce charge for First-Class Mail flats. In connection with these attempts, GameFly met and communicated several times with Postal Service officials and counsel. Its efforts to reach agreement with the Postal Service on its objectives, however, were unsuccessful.

GameFly complains concerning what it characterizes as a common problem in the DVD rental industry. Unlike the vast majority of mail in the First-Class Mail letter and flats mailstreams, DVDs are relatively fragile. They exhibit

a tendency to break during handling, and particularly during processing on Postal Service letter automation equipment. Breakage can be costly. Damage to rental DVDs incurred in processing and delivery can significantly impair rental companies' finances. Game DVDs tend to cost substantially more than DVDs with movies or other content. There is also evidence that Game DVDs have physical characteristics that make them more susceptible to breakage.

The DVD rental industry consists of a relatively small number of firms that use the mails. In this group, Netflix is by far the largest and generates approximately 97 percent of DVD mail volume. Blockbuster generates approximately 2 percent, and GameFly generates less than 1 percent. All other DVD rental companies generate the remaining, relatively minute volume of DVD mail.

GameFly focuses its Complaint on what it describes as a central feature of Postal Service processing operations. The Postal Service, in all of its processing activities, follows an operational policy of deferring to local management's judgment. For the most part, decisions involving the particular modes and steps used for processing and delivering DVDs in the mail are made by local, District, and Area managers. These decisions are not dictated by national headquarters. For the vast majority of First-Class Mail, local assessments of operational requirements result in automated or machine processing of First-Class Mail letters and flats. DVD volumes represent a relatively small part of the overall First-Class Mail mailstream, which encompasses a wide variety of types of mail having varied physical attributes.

Because of their distinct physical characteristics and mailing patterns, DVDs in the mail have induced differences in collection, transportation, processing, and delivery decisions at the local level. On the outbound trip (from rental company to customer), most DVD letter mail receives processing on automation equipment and other mail processing machines. On the return trip (from customer to rental company), letters containing DVDs are generally treated as single piece mail which can be processed by machine, or which can receive manual culling so as to avoid subsequent automated or, if otherwise necessary, manual distribution. Election of certain options by the mailer (such as Business Reply or Confirm service) can require specific types of machine processing.

On the return trip, Netflix DVDs have relatively unique characteristics. Netflix has a highly dispersed group of customers nationally. Because of their high volumes daily in virtually every location, Netflix return DVDs exhibit high densities in most locations. Netflix also maintains nearly 60 distribution centers nationwide. Local Netflix facilities send trucks to postal centers to pick up their mail, rather than having it delivered. These and other practices contribute to the efficiency and effectiveness of mail service from the standpoints of both Netflix and the Postal Service.

Because of its dramatically smaller size, GameFly's distribution and processing operations are markedly different. GameFly maintains only four distribution centers. Its much smaller volumes and dispersion nationwide result in very low densities of mail locally on the return trip.

Netflix and Blockbuster also use highly distinctive, colored mail packaging that makes the DVDs easy to identify in the mailstream. GameFly, which mails flats, rather than letters, uses less distinctive or recognizable packaging.

As a result of the physical differences in volumes, densities, packaging, and mailing practices among DVD mailers, distinct patterns have developed in processing decisions at the local level. A high majority of the higher-volume and density Netflix DVDs are culled from the mailstream to avoid repeated processing steps for each mailpiece. These patterns result in a high percentage of Netflix DVDs avoiding processing on sortation machines. These operations also lower substantially the risk that the DVDs will be damaged by machine processing.

A DVD rental company that might mail dramatically smaller volumes at letter rates would be exposed to a higher risk of breakage on processing machines, particularly if its mailpieces were less susceptible to identification and culling by virtue of their densities and packaging. Several of the much smaller rental companies regularly assume that risk by mailing at letter rates.

GameFly has always chosen to mail at flats rates, which are substantially higher than letter rates, and to insert protective material in its DVD packaging which adds additional protection from breakage. The added weight of protective material leads to even higher rates for two-ounce First-Class Mail flats.

GameFly's central contention in its Complaint is that it is effectively forced to mail at higher flats rates, since, if it were to mail at letter rates, it would not receive the same treatment in processing operations that Netflix and to a limited extent, Blockbuster receive. In other words, local operations decisions would

result in a higher proportion of GameFly's hypothetical letter mail being processed on machines than Netflix DVD mail is exposed to in actual operations. As a result, GameFly DVDs would be damaged by machines at a higher rate that GameFly is willing to sustain. However, GameFly has proven unable to identify what level of breakage it would find acceptable. GameFly reasons that the Postal Service's policy of reliance on local processing amounts to a refusal or denial to GameFly of the operations to which Netflix DVDs are typically exposed. GameFly attributes this hypothetical difference in treatment to a conscious decision by the Postal Service to discriminate in favor of Netflix and Blockbuster and against GameFly. GameFly asserts that this discrimination in operations is one of several undue preferences that the Postal Service gives to Netflix. Other preferences include the failure to charge Netflix return pieces a nonmachinable surcharge, granting Netflix personnel inordinate access to local operating managers, and the Postal Service's failure to establish a separate rate for DVD First-Class Mail.

On the eve of filing its Complaint, GameFly's counsel presented an ultimatum to the Postal Service's General Counsel. GameFly demanded that the Complaint would be filed unless the Postal Service submitted to GameFly, by April 22, 2009, a "concrete proposal for processing GameFly DVDs on terms and conditions offered to two large DVD mailers, Netflix and Blockbuster." When such a proposal was not forthcoming, GameFly filed its Complaint.

On May 17, 2010, Postal Service counsel communicated to counsel for GameFly an offer by the Postal Service to provide GameFly with processing

comparable to Netflix, subject to the same conditions as Netflix faces. The conditions related to practices currently followed by Netflix, including use of distinctive packaging and use of a comparable number of pick-up points. The Postal Service's offer was not inflexible, and offered to discuss alternatives to the stated conditions. GameFly has not responded to the offer and generally has taken the position in this litigation that the offer does not represent a realistic opportunity to achieve GameFly's objectives.

GameFly filed its Complaint on April 2, 2009. Pursuant to the Presiding Officer's directions, GameFly and the Postal Service collaborated on a Joint Statement of Undisputed and Disputed Facts, which was filed July 20. The purpose of the joint statement was to narrow the scope of discovery. Notwithstanding production of such a statement, GameFly pursued extensive discovery against the Postal Service throughout the summer and fall of 2009. During discovery, the Postal Service produced thousands of documents of all types, including tens of thousands of pages of internal Postal Service correspondence from all levels of the organization.

GameFly filed its direct case on April 12, 2010. It consisted of the direct testimony of Sander Glick, a consultant retained by GameFly to analyze the rates and costs of GameFly flats First-Class Mail versus Netflix letter mail. GameFly also filed its Memorandum of GameFly, Inc. Summarizing Documentary Evidence. This document consisted of legal argument that cited numerous documents produced by the Postal Service in discovery.

GameFly's one witness was cross-examined by the Postal Service during hearings on June 17, 2010. In response to the Postal Service's motion, the Presiding Officer directed GameFly to provide a witness to answer questions regarding GameFly's answers to certain institutional discovery responses. The Presiding Officer denied the Postal Service's motion for a witness to sponsor GameFly's Memorandum that summarized and characterized the documents provided during discovery. Hearings to cross-examine GameFly's Chief Executive Officer, as well as Mr. Glick, were conducted on July 28, 2010.

The Postal Service filed its direct case on July 29, 2010. It consisted of the written direct testimony of four witnesses, two field operations managers, one headquarters operations official, and an expert on the subject of DVD composition and damage. After extensive additional discovery by GameFly, the witnesses testified in hearings conducted on October 5 and 14, 2010.

GameFly filed the surrebuttal testimony of Sander Glick on October 21, 2010. Hearings to cross-examine Mr. Glick were conducted on October 28, 2010.

This case represents the second Complaint action filed pursuant to 39 U.S.C. § 3662(a). Due to the extensive nature of discovery, it has been pursued intensively over the course of nearly 19 months. In light of GameFly's serious allegations of unlawful discrimination under 39 U.S.C. § 403(c), the Complaint presents important questions of fact and law that could have a significant impact on Postal Service operations policies and practices.

SUMMARY OF ARGUMENT

GameFly's Complaint raises important questions involving the application of 39 U.S.C. § 403(c) to facts describing the Postal Service's operations policies and practices in processing and delivering First-Class Mail letters and flats containing DVDs. GameFly's Complaint in this regard has evolved. Originally, GameFly alleged disparities between the Postal Service's obligations and responsibilities to process mail entered by GameFly as First-Class Mail flats, and alleged discriminatory treatment in favor of Netflix and Blockbuster and against GameFly in the Postal Service's operations policies and practices. In this connection, GameFly alleged violations of policies embodied in 39 U.S.C. §§ 403(c) and 404(b). GameFly has, since filing, dropped its arguments regarding section 404(b) and added allegations regarding violation of the Filed Rate Doctrine, which encompasses legal principles that have arisen mainly in the context of regulation of industries other than the Postal Service.

The legal standards for evaluating claims of undue and unreasonable discrimination under section 403(c) have arisen out of a number of judicial decisions and prior Commission precedents. GameFly presents a simplistic checklist for assessing discrimination that calls for the Commission to make findings on the record of "similarly situated" status, discrimination in fact (difference in treatment), and reasonableness of the alleged discriminatory conduct. While these elements are all related to claims under section 403(c), the required analysis is not simplistic. Based on prior judicial and Commission precedent, the Commission must carefully evaluate the facts in light of the

distinct relationships among the parties and the Postal Service. Under this analysis, the differences among GameFly's and Netflix's practices and capabilities must be assessed on a record of reliable evidence. This will involve, not only a comparison of the size and nature of their mailings, but their capabilities, business choices, and actual status as mailers at particular rates. Pursuant to this fact-based approach, the Commission's consideration should regard situational status as part of its overall assessment of reasonableness under section 403(c).

Judicial and Commission precedent establish a realistic, balanced standard for evaluating the reasonableness of the Postal Service's conduct and its rates and classifications. Courts have tended to give the Postal Service broad latitude in acting on distinctions in operations and relevant conditions to justify different treatment among mail users. In this respect, Postal Service conduct should be judged in light of its similarly broad responsibilities and authorities under controlling statutes.

Commission precedent creates no higher standard. The Red Tag decision, on which GameFly principally relies, involved the lawfulness of service differentials among mailers paying the same rate. The Commission's decision was also closely related to its decisions to allocate Service Related Costs. No similar cost allocation factor has been established on the record of GameFly's Complaint. The Commission's decision not to recommend a Citizens Rate Mail rate in Docket No. R77-1 also involved the allocation of Service Related Costs. In that case, however, the Commission determined that it could not recommend a

rate distinction in circumstances where an actual service distinction had not been reliably established on the record. In Docket No. C87-1, the Commission evaluated the reasonableness of discrimination under the Postal Service's regulations and practices governing the use of Detached Address Labels. In light of the Postal Service's evidence establishing DALs as an efficient practice in mail delivery, the Commission concluded that the discriminatory conduct alleged was reasonable and therefore not unlawful.

On the facts that have been established in this proceeding, a Commission determination upholding the lawfulness of the Postal Service's operations policies and practices would be appropriate. Significant differences mark the relationships between GameFly and the Postal Service, on one hand, and Netflix and Blockbuster and the Postal Service, on the other. Of these, the most salient distinction resides in their status as mailers. GameFly deliberately chooses to mail its DVDs as flats, while Netflix and Blockbuster mail letters. In other words, GameFly purchases a different type of service than Netflix. In addition, it has much lower volumes, its mail exhibits different costs and it undertakes a different level of cooperation with the Postal Service. These distinctions dictate an outcome based on a straightforward application of the facts established on the record.

GameFly's argument under section 403(c) rests on an entirely hypothetical proposition that, if it were to choose to mail letters, it would not receive comparable treatment. To make this argument, GameFly also must contend that, in advance of any determination to change mail categories, it has

been denied or refused equal treatment. In this regard, GameFly relies on a constructive interpretation based on an inference from the Postal Service's general operational policy of relying on local judgment in mail processing decisions. GameFly, in effect, argues that, since it is so different in its practices and capabilities, and the quantity and density of its mail, local decisions would not lead to providing treatment equal to Netflix. GameFly attributes this hypothetical result to a conscious decision by the Postal Service to favor Netflix, against GameFly's interests. Yet, GameFly has not been able to establish through reliable evidence that the Postal Service's current posture toward Netflix, or its hypothetical posture toward GameFly, is or would be influenced by anything other than a practical and objective assessment of operational requirements in light of local conditions by field managers.

To the contrary, the Postal Service has submitted substantial evidence from operations managers that demonstrates that the Postal Service's decisions that result in removing a large percentage of Netflix mail from the mailstream prior to distribution avoids either automation or manual processing steps and, on balance, saves costs, rather than creating them. In this regard, the Postal Service has explained that the efficiency of these decisions is guaranteed by the strict discipline of financial and budgetary controls, within the framework of financial planning and operations imposed within the postal system nationwide. GameFly's suggestion that a reliable record has been established to conclude that processing Netflix mail costs more than it would if the Postal Service's practices were not followed is based on a flawed study by Christensen

Associates, which has not been sponsored or its conclusions justified by reliable record evidence.

A fair reading of the record should lead to the conclusion that the Postal Service's operations decisions of which GameFly complains are reasonable and supported by substantial evidence. Regarding GameFly's inference that it has been "refused" equal treatment, the Postal Service has officially offered to process GameFly's mail equally, if it were to mail as letters, under conditions that relate to realistic capabilities by Netflix as a mailer. GameFly has not responded to this offer or successfully explained why it does not undermine its arguments.

Beyond the substantive issues involving the establishment of reasonableness under section 403(c), the Postal Service has serious concerns about the integrity of the record in this proceeding. GameFly's approach to proving its case by relying on unreliable and unsponsored documents obtained from the Postal Service in discovery represents substantial legal error. Applicable precedent embodying sound legal principles would support declining to recognize the status of these documents as evidence that can be relied upon to support GameFly's case. More importantly, the decision to allow GameFly to proceed without offering testimony or other evidence supporting its own interpretations and conclusions based on the documents also represents legal error. As a consequence of this approach, the Postal Service has been denied its due process rights to mount an effective defense. Furthermore, the Postal Service has submitted substantial evidence to support its contentions that the

documents GameFly relies upon are unreliable, and that GameFly's interpretations and use of them are unsound.

Finally, the Postal Service rejects GameFly's strained interpretation of the Filed Rate Doctrine to justify its discrimination claims or to otherwise provide an independent basis for complaint. GameFly has pointed to no principle in the Commission's rules or precedent, or in applicable judicial precedent, that would support this claim. Simply put, the Filed Rate Doctrine does not apply.

ARGUMENT

I. THE LEGAL STANDARD FOR EVALUATING UNLAWFUL DISCRIMINATION IS CONDITIONED BY THE FACTUAL CONTEXT OF GAMEFLY'S COMPLAINT

Throughout the course of this proceeding, GameFly has, on various occasions, asserted a legal standard for evaluating unlawful discrimination under 39 U.S.C. § 403(c). GameFly's April 12 Memorandum describes "The Governing Legal Standards,"[1] which GameFly elaborates upon while explaining why "The Disparity Between The Rates and Service Offered To Netflix and GameFly Is Discrimination Under Section 403(c)." *Id.* at 49-51. In several other pleadings, GameFly has described "[t]he legal elements of a discrimination case,"[2] asserting that "the basic elements of a discrimination case under Section 403(c)(3)[sic] are well established."[3]

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[1] GameFly Memorandum at 47-49.

[2] Answer of GameFly Inc. to Motion of the USPS for Another Opportunity to Cross-Examine an Institutional GameFly Witness, Docket No. C2009-1, at 13-17 (June 23, 2010)(June 23 Answer).

[3] Answer of Gamefly Inc. to Motion of USPS to Postpone Hearing, Docket No. C2009-1, at 8-11 (June 3, 2010)(June 3 Answer); Answer of GameFly Inc. to Motion of USPS to Compel Answers to Discovery Requests USPS/GFL-5, 8,16, 26, 28, 38, 46, 49-51, 52(e), 54 and 60, Docket No. C2009-1, at 2-3 (May 14, 2010)(May 14 Answer).

GameFly's explanations of the applicable legal standard in this Complaint rely heavily on precedents from public utility law in other industries. GameFly's Memorandum asserts: "Under Section 403(c) and cognate statutes, discrimination occurs when "'(1) two classes of customers are treated differently, and (2)…the classes of customers are similarly situated.'" This quote comes from a Federal Energy Regulatory Commission (FERC) opinion.[4] The Memorandum quotes another FERC opinion to explain that "Undue discrimination is in essence an unjustified difference in treatment of similarly situated customers." GameFly Memorandum at 50.[5]

The Postal Service does not contest the general description embodied in these quotations. It must be noted, however, that both of the FERC cases that GameFly cites as authority for interpreting 39 U.S.C. §403(c) under Commission practice involved complex disputes over differential pricing within an industry significantly different from the postal system, and under controlling statutes markedly different from either the Postal Reorganization Act (PRA) or the Postal Accountability and Enhancement Act (PAEA).[6] While the basic bifurcation of issues described in the quotations is not a completely inappropriate place to start in evaluating GameFly's claims of unlawful discrimination, under Commission practice and the law that applies to the Postal Service, they do not provide a roadmap to analyzing GameFly's Complaint.

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[4] *Energy Transfer Partners, L.P., 120 FERC* ¶ 61,086, 169 (July 26, 2007).
[5] Citing *Transwestern Pipeline Co.,* 36 FERC ¶ 61, 175m at 61, 433 (Aug. 4, 1986). For the same quote, GameFly cites *Sea-Land Service, Inc. v. I.C.C.,* 738 F.2d 1311, 1317 (D.C. Cir. 1984).
[6] The *Sea-Land* case involved a contract rate dispute arising under statutes governing transportation within the ambit of the Interstate Commerce Commission.

GameFly does rely principally on one Commission opinion and recommended decision addressing discrimination under section 403(c), namely, the Red Tag Proceeding, which arose in 1979.[7] In Red Tag, the Commission expressed findings about discrimination in the context of the Commission's recommendation to the Governors of the Postal Service concerning the pricing and classification for two groups within Second-Class Mail. The Commission's opinion, however, did not enunciate any concise test for evaluating all claims of discrimination under section 403(c), contrary to GameFly's suggestion. Rather, the Commission addressed the discrimination issue by assessing the particular facts at issue in Red Tag, on a discrete evidentiary record, which had a controlling influence on the Commission's recommendations to the Governors. As discussed below, subsequent cases in which the Commission addressed the requirements of section 403(c), also entailed a close tie to the particular facts being evaluated by the Commission, in light of claims that conduct, classifications, or rates were unlawfully discriminatory.

In light of the Commission's practice and precedent, as opposed to GameFly's assertion of legal principles and precedent applicable in other industries, the precise nature of GameFly's claims, and the particular facts established through the evidentiary record, assume critical importance. Much of GameFly's rhetoric has sought to capitalize on the emotional appeal of its argument that the Postal Service has had a tendency to favor Netflix as a large,

[7] PRC Op. MC79-3, Docket No. MC79-3 (May 16, 1980). The Red Tag proceeding was not initiated as a discrimination complaint under 39 U.S.C. § 3662. The Commission initiated the case pursuant to its authority to consider classification changes under 39 U.S.C. § 3623.

influential customer.[8] GameFly has, however, diffused its claims of discriminatory conduct by mixing a variety of allegations supported by unsponsored opinions found in internal Postal Service correspondence. GameFly has also relied on extrapolations and innuendos that it draws from a variety of types of information obtained in discovery. The central element of GameFly's complaint rests on the difference in handling Netflix DVDs in processing operations, compared to a hypothetical situation involving a mailer, who might not have the same profile or characteristics presented by Netflix mail, but who might conceivably choose to pay for returns of DVD mail at First-Class Mail single-piece letter rates.[9] For such a hypothetical mailer, GameFly posits a companion allegation that the Postal Service has "refused" to handle DVD return mail with the same treatment given to Netflix mail. *Id.* at 37-44. GameFly alleges that the direct consequence of this hypothetical situation is that GameFly "must pay flat rates," incurring additional round trip postage of $1.22 compared to the rate Netflix pays. *Id.* at 2.

Beyond this central allegation, GameFly also complains of other alleged preferences, such as "unjustified classification of the Netflix Reply Mailer as Machinable," *id.* at 14, "Netflix oversight over Postal Service operations," *id.* at

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[8] GameFly states: "Netflix, however, is a large, rapidly-growing and powerful customer of the Postal Service." GameFly Memorandum at 13. "Netflix has not hesitated to use its leverage as a large and growing customer to carve out exceptions for itself from the 'classifications and rates' available to other mailers, and to 'make changes' in the rules 'as they [Netflix] see fit.'" *Id.*

[9] GameFly states: "This case is about the caste system that the Postal Service maintains among its customers in the DVD rental industry….For Netflix (and, to a lesser extent, Blockbuster), the Postal Service has 'solved' the DVD breakage problem by offering an array of preferential treatment – including hand-culling, diversion from the automation letter stream, and hand processing – at no extra charge." GameFly Memorandum at 1. *See also id.* at 14 (para. 42).

26, “dedicated Netflix-only mail drop slots,” *id.* at 30, and the Postal Service shrinking “from requiring Netflix to Pay Extra for its preferential treatment.” *Id.* at 33. Apart from these claims being immersed in the general climate of discrimination in favor of Netflix and Blockbuster that GameFly alleges, GameFly is unclear about the specific roles these elements play in the alleged discrimination against GameFly, or about the consequences of these elements for GameFly.

For the Commission to apply any legal standard derived from section 403(c) to the facts of this case, it will be necessary to focus on the precise nature of the Postal Service conduct, or other conditions, of which GameFly complains. The analysis of discrimination embodied in the decision to cull Netflix mail, but not the mail of a hypothetical mailer, might be different from the analysis of discrimination embodied in the conduct of “shrinking” from charging Netflix more. Only in the context of the precise nature of the conduct or other condition claimed to be discriminatory will the general principles that GameFly enunciates have any meaning.

Up to now, GameFly has not been clear in addressing the specific elements of its complaint, except to argue that, collectively, the discrimination it alleges should be condemned. Most importantly, Netflix has not identified particular remedies that would rectify the conditions about which it complains (although GameFly would apparently welcome lower rates than other First-Class Mail two ounce flats otherwise incur).

A. GameFly's Complaint Has Evolved.

GameFly's original complaint listed four causes of action:

1) The Postal Service's practice of manually processing the DVDs entered by certain large DVD mailers as one-ounce letters, while failing to offer similar treatment to the DVDs of GameFly and other similarly situated mailers, violates 39 U.S.C. § 403(c), which prohibits undue or unreasonable discrimination and undue preferences and prejudices among users of the mail. (Para. 49)

2) The Postal Service's practice of providing flats processing to most mail matter entered at the higher rates for flat-shaped First-Class Mail, while providing letter processing to DVDs entered at rates for flats by GameFly and similarly situated mailers unless they also pay the second-ounce rate, violates 39 U.S.C. § 403(c), which prohibits undue or unreasonable discrimination and undue preferences and prejudices among users of the mail. (Para. 51)

3) The Postal Service's practice of collecting flats rates for DVDs entered by GameFly and similarly situated mailers as First-Class flats, but processing the same DVDs on letter-sorting equipment unless the mailer also pays second-ounce postage, is an unreasonable practice in violation of 39 U.S.C. § 404(b). (Para. 53)

4) The Postal Service's practice of collecting flats rates for DVDs entered by GameFly and similarly situated mailers as First-Class flats, but failing to process the DVDs on flats-sorting equipment, is an unreasonable practice in violation of 39 U.S.C. § 404(b). (Para. 55)

Under "Relief Requested," the Complaint specified:

- In light of the foregoing, GameFly respectfully requests that the Commission (1) promptly hold hearings on this complaint and (2) on the basis of the resulting record, prescribe reasonable and nondiscriminatory rates and terms of service for GameFly. (Para. 56)

- This relief should include, *inter alia*, an order prescribing the same prices and terms of service for GameFly, including the same degree of manual processing, that the Postal Service provides to Netflix and Blockbuster. GameFly reserves the right to propose additional forms of relief as the evidentiary record justifies. (Para. 57)

As this case has evolved, GameFly seems to have modified its legal claims somewhat. The cause of action described in (2), above, alleges that the Postal Service extracts flats rates from GameFly but provides only letter processing to GameFly's DVDs and other similarly situated mailers, unless they also pay the second ounce rate for flats. GameFly contends that this "practice" violates 39 U.S.C. § 403(c). The cause of action in (3), above, alleges that this same practice violates 39 U.S.C. § 404(b). The cause of action in (4), above, alleges that the practice of extracting flats rates from GameFly, but not providing processing on flats-sorting equipment, is "unreasonable" and violates 39 U.S.C. § 404(b).

In pleadings filed since the Complaint, and in its testimony, GameFly appears to have dropped causes of action 2) through 4). GameFly no longer argues that the Postal Service is providing letter processing to GameFly at flats rates, and that this practice violates section 404(b),[10] or that the Postal Service has placed a condition on its provision of flats service that GameFly's flats will only be processed on flats equipment, if GameFly pays the rate for second-ounce flats.

GameFly's Memorandum, which outlines arguments presented in GameFly's "direct case," argues that "The Postal Service's Preferential Treatment of Netflix

[10] GameFly's decision to drop its allegations under section 404(b) is likely the result of the Commission's order on the Postal Service's motion to dismiss filed at an early stage of the proceedings. Order Denying Motion of United States Postal Service for Partial Dismissal of Complaint and Notice of Formal Proceedings, Order No. 235, Docket No. C2009-1 (July 1, 2009). In its motion, the Postal Service argued that section 404(b) was not included in the permissible grounds for complaint under 39 U.S.C. § 3662(a). While the Order apparently acknowledges the absence of section section 404(b) as a basis for complaint under section 3662(a), it concluded that GameFly's Complaint could be considered under allegations that the Postal Service had violated 39 U.S.C. §§ 101(d) or 403(c).

Violates 39 U.S.C. § 403(c)." *Id.* at 45. In describing "the governing legal standards," GameFly does not cite 39 U.S.C. § 404(b), or rely principally on 39 U.S.C. § 101(d),[11] but, rather, refers largely to section 403(c). The Memorandum states: "The Disparity Between the Rates and Services Offered to Netflix and GameFly is Discrimination under Section 403(c)." *Id.* at 49-51. GameFly further argues: "The Discrimination Among DVD Rental Companies is Undue and Unlawful." *Id.* at 52. In connection with this claim, GameFly argues: 1) the Postal Service cannot, in effect, shift responsibility for its unlawful conduct by relying on local decision-making in the field (*Id.* at 52-57); 2) the Postal Service cannot, in effect, justify its conduct by relying on the efficiency of its operations (*Id.* at 57-60); and 3) the Postal Service cannot justify its conduct by claiming that it is infeasible to give all DVD rental companies the same "level of service." (*Id.* at 60-63)

GameFly has also added an independent cause of action. GameFly argues: "The Preferences Given to Netflix and Blockbuster also Violate the Filed Rate Doctrine." *Id.* at 63-65.

The precise nature of GameFly's requested relief in the context of the current state of its factual and legal contentions is unclear. GameFly has not made an explicit allegation and argument that the First-Class Mail automation or single-piece rates for flats and letters, respectively, are illegal for any reason.[12] In particular, it has addressed only a small segment of First-Class rates in its

[11] GameFly cites section 101(d) as reflecting the "norms" embodied in section 403(c). *See* GameFly Memorandum at 48, n. 6.

[12] In this regard, it is noted that GameFly does not appear to have filed comments challenging the Postal Service's First-Class Mail rates in connection with the Postal Service Annual Compliance Report (ACR) for FY 2009.

testimony and arguments pertaining to the DVD mail presented by GameFly and Netflix. The prayer for relief in the Complaint states that the Commission should "prescribe reasonable and nondiscriminatory rates and terms of service for GameFly." The Complaint also asks for "an order prescribing the same prices and terms of service for GameFly, including the same degree of manual processing, that the Postal Service provides to Netflix and Blockbuster." GameFly's direct testimony from witness Glick (GFL-T-1) purports to establish that the rates that GameFly pays for First-Class Mail flats at the two-ounce level exceed the cost difference between service under that classification compared to the First-Class Mail letter classifications that encompass Netflix DVD mail.[13] GFL-T-1, at 1-2. Witness Glick's testimony, however, does not appear to present or support any legal conclusion regarding the rates he contrasts.

GameFly's Filed Rate Doctrine argument appears to assert that the classification for First-Class Mail products should be modified. In this regard, GameFly contends that the doctrine would dictate that the *actual* service given to Netflix at the automation and single-piece letter rates it pays, *i.e.*, the "preferences" Netflix enjoys, should be incorporated in the Domestic Mail Manual (DMM) and the Mail Classification Schedule (MCS).[14] Memorandum at 63-64 ("[T]hese preferences are *per se* illegal because they amount to rates and classifications that have never been properly published.") From this, it might be inferred that GameFly is also seeking an order from the Commission that would reclassify First-Class Mail to include a special category that would provide a

[13] *See also*, Memorandum at 42 (Para. 103).
[14] A final MCS has not yet been proposed or adopted by the Commission.

particular type of mail processing to round-trip DVD mail for a lower rate than currently paid by GameFly under the First-Class Mail flats product classification.[15]

GameFly's Filed Rate Doctrine argument, however, does not seem to operate through section 403(c). Rather, GameFly contends that the doctrine "is an essential corollary of Section 403(c) and similar prohibitions against unjust discrimination among ratepayers." *Id.* at 64-65 (citations omitted). As such, it might be considered as included in the "governing legal standards" that GameFly describes. *Id.* at 47.

While it might be inferred from the discussion above that GameFly contends the rates paid by GameFly for flats are discriminatory and should be changed, GameFly's case has not been developed to establish this through any evidence of record assessing the First-Class Mail flats rates. Witness Glick's direct testimony purports to show a disparity between the differences between rates for flats paid by GameFly and the rates for letters, compared to the differences between the costs of *processing* GameFly DVDs as flats and the costs of processing Netflix DVDs as letters. Yet, except for mentioning the difference in postage that the rate differential represents, neither witness Glick, nor GameFly's

[15] This inference finds support in questioning by GameFly of Postal Service witnesses at hearings, *see* Tr. 10/1878-1882, and by GameFly's narrative description of events leading up to the filing of its Complaint. In its Memorandum, GameFly explained that GameFly had requested the Postal Service to offer a reduced rate for round-trip DVD mailers, or a "niche classification." Memorandum at 41 (Para. 100). Just prior to filing, GameFly sent an ultimatum to the Postal Service's General Counsel threatening to file a complaint, unless the Postal Service submitted a "concrete proposal for processing GameFly DVDs on terms and conditions offered to two large DVD mailers, Netflix and Blockbuster." *Id.* at 44 (Para. 110). *See also,* Joint Statement of Undisputed and Disputed Facts, Docket No. C2009-1, at 20-21 (July 20, 2009).

Memorandum address the First-Class Mail flats and letter rates as they currently exist. Nor has GameFly's evidence and argument addressed the other attributable costs, assigned costs, cost coverage, or rate design of the flats or letter rates. Similarly, beyond criticism of the Postal Service's failure to impose a non-machinable surcharge on Netflix return DVD mail, GameFly does not appear to argue that the rates for First-Class Mail automation or single-piece letters are unduly discriminatory.[16]

Rather, GameFly appears to argue that, because of the combined effect of the "preferences" afforded Netflix through the treatment given to Netflix DVDs in mail processing (*i.e.,* the majority of Netflix DVDs are "processed manually"), GameFly pays more for mailing its DVDs as flats, because it would receive a different type of processing than Netflix were GameFly to mail its DVDs as letters.

GameFly's initial brief might clarify the status of its discrimination claims. On the face of its Complaint, direct case, and pleadings, the Postal Service has concluded that the "discrimination" of which GameFly complains centers on the processing of Netflix DVD mail as the cause of GameFly's choice to mail as flats. GameFly could also be claiming that the other "preferences" described in its Memorandum also constitute discrimination, but the causal link between Postal Service conduct and any existing adverse consequence to GameFly has not been clearly explained.

B. A Finding of Undue or Unreasonable Discrimination Must Rest on Evaluating Actual Conduct Established on the Record.

[16] This conclusion flows from the logic behind questioning of the Postal Service's witness Barranca during hearings. *See* Tr. 10/1878-1882.

In explaining the applicable legal standard, GameFly's Memorandum and its pleadings describe a three-part test that controls evaluation of discrimination claims under section 403(c).[17] According to GameFly, the complainant must first establish that the victim of discrimination is similarly situated compared to the beneficiary. Second, the complainant must show that the Postal Service discriminates "by offering a lower price or better terms and conditions of service to a similarly situated ratepayer, but not to the complainant." *Id.* at 9. Third, once these elements are established, the Postal Service must show that the discrimination is reasonable. *Id.*

A three-part test may be analytically neat. Emphasizing a mechanical test, however, risks overshadowing the practical, comprehensive approach that the Commission has applied in prior proceedings to evaluate the reasonableness of discrimination under section 403(c). In recent practice, the Commission has on several occasions addressed the standards under section 403(c) when considering rate differentials embodied in Negotiated Service Agreements (NSA's). GameFly cites several of these cases in its efforts to describe the statutory standard. What emerges from these precedents, as well as other, prior proceedings, however, is not so much a mechanical test of discrimination, but rather a focus on the specific factual context in which the claims of discrimination have arisen. This context encompasses all of the factual elements of the situation being evaluated, including: 1) the status of the party alleging discrimination and the status of the party or class that benefits, 2) the operational

[17] June 8 Answer, at 8-9.

and administrative circumstances that define the conduct or condition identified as discriminatory, and 3) the legal and policy principles or provisions of authority that give rise to the Postal Service's assertion of a reasonable basis for its conduct.

Because the initial consideration of NSA contract rates also needed to consider whether the contract pricing approach passed the threshold of acceptability under section 403(c), the Commission in the NSA cases focused on the status of the mailer for whom the NSA was intended. In Capital One, the first case where an NSA was considered,[18] the Commission stated:

> The described conditions may, or may not, make Capital One's First-Class solicitation mailings unique in the postal system. However, the Commission does not understand § 403(c) to preclude preferences for mailers whose circumstances are other than "unique." Rather it requires that any identified user preference have a reasonable justification. In view of the significant cost-saving opportunities that the terms of the Postal Service-Capital one NSA make available to the Postal Service, the Commission finds no violation of the prohibitions in § 403(c).

Id. at 29 (citation's omitted). In subsequent cases considering NSA's patterned after the Capital One contract, the Commission discussed extensively the relationships between the proposed NSAs and their baseline antecedents. These discussions focused on the status of the contracts as "functionally equivalent," rather than the factual context that defined the relationship between a complainant alleging discrimination, the beneficiary of discrimination, and the Postal Service, as discussed below.

By far, the most salient feature of Commission precedents considering discrimination under section 403(c) has been the Commission's emphasis on the

[18] PRC Op. MC2002-2, Docket No. MC2002-2 (May 15, 2003).

specific facts of the situation described by the party alleging discriminatory treatment. In Capital One, the Commission stated:

> As the OCA has noted in reply comments, determining whether any given preferential benefit is "undue or unreasonable" requires a factual inquiry. Further, in examining record evidence to determine whether a particular preference is undue or unreasonable, that determination depends on whether there is a rational basis for treating a single mailer differently from others.

Id. at 29 (citation omitted). In distinguishing its earlier determination disapproving contract rates in Docket Nos. R87-1 and R90-1, the Commission stated:

> In Docket No. R87-1, the Commission declined to recommend volume discounts proposed by the Postal Service for Express Mail; in Docket No. R90-1, the Commission rejected a similar proposed discount for the same service. In both instances, rejection was based on the Commission's assessment that the proposed discounts were unsupported by any measureable cost differences between low-volume and high-volume mailings or other empirical justification.

Id. at 29-30 (citation omitted). The Commission elaborated on this condition in the proceeding in which it reviewed the Bookspan NSA:

> In the Capital One Case, the Commission found that in these two omnibus rate proceedings "rejection was based on the Commission's assessment that the proposed discounts were unsupported by any measurable cost difference between low-volume and high-volume mailings *or other empirical justification.*" Participants highlight the terms "cost difference" in that sentence, but fail to take notice of the fact that the sentence also notes that "other empirical justification" may exist to support volume-based discounts. Such other empirical justification could result in NSAs that do not have measurable cost differences if the NSA meets those requirements outlined above.[19]

The Commission must accordingly assess all of the factual circumstances that are established through reliable record evidence, as well as the empirical justification for differential treatment. The Commission must be careful, however,

[19] PRC Op. MC2005-3, Docket No. MC2005-3, at 37 (May 10, 2006)(citation omitted).

to focus on the actual conduct giving rise to the claimed discriminatory effect. While in the abstract discrimination claims based upon a hypothetical situation might be a useful consideration, the Commission should not lose sight of the very real context of this complaint proceeding under 39 U.S.C. § 3662(a), where the purpose is to initiate corrective action against the Postal Service for allegedly breaching its responsibilities under section 403(c). Any finding of discrimination must be based on the actual facts established on the record, not a constructive conclusion based on hypotheticals, unfounded inferences based on unsponsored interpretations of unreliable records, or vague conclusions based on unsupported notions of general institutional bias. Furthermore, if the claim of discrimination is directed at particular rates or classifications, the Commission should insist on tangible proof that addresses the alleged illegality of these existing rates, classifications or product descriptions. In this regard, the Commission should hold the complainant to a strict standard of demonstrated illegality or unreasonableness through sponsored testimony, in light of, and within the context of, the Commission's own comprehensive annual review of Postal Service products and prices under the PAEA. While the structure of the PAEA may accommodate complaints as a critical element of overall regulatory oversight, complainants should not be permitted to sustain claims of discrimination without addressing the many considerations that annual review and approval of rates and products entails. In other words, superficial comparisons of partial segments of the mail that the challenged rate represents,

based on incomplete models of costs and rates, should not be adequate to invalidate established rates.

The context of the instant GameFly complaint requires the Commission to begin with a careful examination of the central fact alleged as the basis of the discrimination claims. As noted above, based on GameFly's Complaint and direct case, this factual predicate seems to be that the Postal Service favors Netflix and Blockbuster by allowing the essential need for efficient and effective processing of all mail to drive operational policy that, in light of the dynamic local mix of mail, equipment, and resources, defers to local management's judgment in deciding how to handle, process, and deliver First-Class Mail containing DVDs. As represented by GameFly, this operational practice results in the "manual processing" of a large percentage of DVDs returned by their customers to Netflix and Blockbuster by First-Class Mail. According to GameFly, this same "manual processing" could not be realized by GameFly, if it were to mail at the same rates as Netflix and Blockbuster. Moreover, according to GameFly, if the Postal Service were to offer GameFly service based on the identical conditions applicable to Netflix and Blockbuster, promises included, that would not suffice in GameFly's view; instead, the Postal Service would need to change completely how it now manages mail processing nationwide, cease deference to local managers' knowledge of local conditions, and extend a promise only to GameFly that would change how GameFly's mail would be processed. *See* Tr. 11/1961-1966.

To consider GameFly's undue discrimination claim in context, the Commission must compare GameFly to Netflix, and to a lesser extent Blockbuster, including a comparison of the characteristics of the three firms as mailers. As discussed below, however, the Commission should not follow GameFly's simplistic checklist approach to establishing GameFly's status as "similarly situated." That condition is not a checklisted criterion, but the foundation for consideration of the alleged discriminatory conduct or policies.

Finally, GameFly may insist that its other claims of discriminatory conduct or treatment, such as its pricing policy regarding First-Class Mail, cannot be separated from its overall complaint. The Postal Service urges the Commission, however, to focus on these elements of GameFly's contentions with an independent assessment of their roles in the alleged discrimination and their reasonableness under the Postal Service's authorities and responsibilities.

C. GameFly's Identity and Characteristics Are Critical Elements in Evaluating the Reasonableness of the Postal Service's Conduct

GameFly spends considerable effort attempting to establish that GameFly and Netflix are "similarly situated," which GameFly erects as the first leg of its three-part test.[20] GameFly hopes to check this box by simply asserting similarity

[20] May 14 Answer, at 3-6; June 8 Answer, at 11-14; June 23 Answer, at 13-15.

based on a superficial comparison[21] of its status as a mailer who pays First-Class Mail rates for renting DVDs to customers.[22]

GameFly relies heavily on Commission opinions considering NSA proposals in various dockets. GameFly generally equates the status of "similarly situated," with the Commission's discussion of "functional equivalence" in considering proposed NSAs. The principal point GameFly seeks to establish through these references is that, under the Commission's practice, mailers need not be identical to be considered "similarly situated," when evaluating claims of discrimination under section 403(c).[23] Thus, GameFly argues:

> "Minor," "incidental" or "immaterial" differences between two customers' mail do not make them unalike….Thus, for example, it is immaterial to the question of functional equivalence or substantial similarity whether two ratepayers are the same size, generate the same amount of mail, impose the identical operating requirements

[21] Differences between GameFly and Netflix are far more substantial than this facile comparison suggests, including mailpiece shape and rates, target market sizes, prices and markets for respective DVD segments, how DVDs are used, distance traveled in the mail, how respective markets are changing, customer identities, and various other distinctions elaborated upon below.

[22] Even taking the conventional approach of, first, establishing status as "similarly situated," courts have erected a high, practical standard. *See General Motors Corp. v. Tracy*, 519 U.S. 278, 298-303 (1997) ("any notion of discrimination assumes a comparison of substantially similar entities"). Two parties are not similarly situated if they purchase different things. *See Nation's Choice Vitamin Co. v. General Mills, Inc.,* 526 F. Supp. 1014, 1018-1019 (S.D.N.Y. 1981) (finding no price discrimination where one entity purchased a license for use in cereals and other entity purchased license for use in vitamins). Two parties are not similarly situated if they operate in different markets. *See Tracy*, 519 U.S. at 299 ("[where] different entities serve different markets, [they] would continue to do so even if the supposedly discriminatory burden were removed"). And two parties are not similarly situated if they do not compete with each other. *See Nation's Choice Vitamin Co.,* 526 F. Supp. at 1018-1019 (finding no price discrimination where entities did not compete). GameFly is not similarly situated to Netflix because (1) GameFly purchases flats service and Netflix purchases letter service; (2) GameFly operates in the flat mailing market and Netflix operates in the letter mailing market; and (3) GameFly, which offers a video game rental service, does not compete with Netflix, which offers a video rental service.

[23] *See* June 23 Answer, at 13.

> on the Postal Service, cost the Postal Service the same to serve, or have the same competitive options.

June 8 Answer, at 11-12.

Yet when each mailer pays different rates for operationally distinct mailpiece shapes, while serving different markets and consequently imposing quite distinct challenges upon the operating environment, and a discrimination claim rests on hypothetical facts making one mailer look more like the others, the Postal Service cannot but disagree. GameFly's position is at least internally consistent in that it pretends the actual facts do not matter, while similarly pretending that hypothetical ones it asserts, but cannot substantiate, actually do matter. The Postal Service agrees that similarly situated mailers who differ only in non-material ways may well be comparable for purposes of determining the reasonableness of disparate treatment. But such facts are not present in this docket.

To the extent that GameFly seems to be arguing against the use of *any* differences between mailers to justify a conclusion that they are not similarly situated, that is, that the mailers must be identical, the Postal Service would not disagree. It bears noting, however, that GameFly's references to the Commission's views on "functional equivalence" in this context are unsupported by the precedent GameFly cites. In most of the cases GameFly cites, the Commission's consideration of "functionally equivalent" pertained to comparison of NSA contracts for purposes of administrative review. In Capital One, the first NSA case, the Commission explained the history and background of the "contract rate" issue. PRC Op. MC2002-2, at 18-23. After reviewing the

procedural history in Commission proceedings, the Commission summarized by explaining that its conclusions regarding the legality of NSAs would apply under three conditions: 1) NSA's would be subject to review in a public proceeding; 2) NSAs must mutually benefit mail users and the postal system as a whole; and 3) NSAs must be available on the same terms to other potential users willing to meet the same conditions of service. *Id.* at 23. The final condition was also emphasized by the Court of Appeals in *UPS Worldwide Forwarding, Inc. v. United States Postal Service*, 66 F.3d 621, at 635 (3d Cir. 1993), which upheld, under section 403(c), the legality of contract rates (ICMs) for international mail, which were not, at that time, subject to the Commission's jurisdiction.

The status of individual mailers applying for NSAs, therefore, might be of relevance to evaluating whether a decision to extend or not extend the same terms of a particular NSA to another mailer was justified. The Commission's discussion of "functionally equivalent" in the cases subsequent to Capital One, however, arose in a different context. As the Commission explained in the Bank One NSA proceeding:

> A request for a Negotiated Service Agreement that is functionally equivalent to a Negotiated Service Agreement previously recommended by the Commission and currently in effect (a baseline agreement) affords the opportunity for expedited review by allowing proponents of the agreement to rely on relevant record testimony from a previous docket. This expedites the proceeding by avoiding re-litigation of issues that were recently litigated and resolved.

PRC Op. MC2004-3, Docket No. MC2004-3, at 37 (Dec. 17, 2004). Accordingly, the Commission's discussion of functionally equivalent status in subsequent proceedings tended to focus on the terms of the agreement itself, to determine

whether review of a particular NSA could be conducted under rules the Commission had crafted for expedited review of functionally equivalent NSA's.[24] In Docket No. RM2003-5, the Commission helped clarify the distinction:

> "Similarly situated" refers to a comparison of the relevant characteristics of different mailers as the characteristics apply to a particular Negotiated Service Agreement….It is possible that two mailers who are not similarly situated could qualify for functionally equivalent Negotiated Service Agreements, given comparable benefits to the Postal Service.
>
> Discussions of whether mailers are similarly situated are more appropriately reserved for allegations of possible discrimination or discussion of competitive issues. A qualifying mailer that is similarly situated to a mailer participating in a Negotiated Service Agreement must have a similar opportunity to participate in a functionally equivalent Negotiated Service Agreement. Not providing this opportunity would raise the possibility of discrimination. In an attempt to differentiate the concepts of functionally equivalent from the concept of similarly situated, the Commission will strive to use the terminology similarly situated only when addressing concerns of competition or discrimination, and not to use similarly situated when addressing application of the functional equivalency rules.
>
> The issue of discrimination might arise in a separate complaint where a mailer alleges that it is similarly situated to a mailer operating under the terms and conditions of a Negotiated Service Agreement, but that it has been denied a similar opportunity to participate in a functionally equivalent Negotiated Service Agreement.

Order Establishing Rules Applicable to Requests for Baseline and Functionally Equivalent Negotiated Service Agreements, Order No. 1391, Docket No. RM2003-5 (Feb. 11, 2004) at 51-52.

Notwithstanding these distinctions between mailers who might suffer from discrimination, in favor of another mailer who is "similarly situated," and the status of "functional equivalence" of NSAs for the purpose of applying the Commission's procedural rules, GameFly further complicates the matter by using

[24] *See* Order Establishing Rules Applicable to Requests for Baseline and Functionally Equivalent Negotiated Service Agreements, Order No. 1391, Docket No. RM2003-5 (Feb. 11, 2004).

both terms to refer to the *mail service* received by GameFly and Netflix. In this vein, GameFly has stated:

> Under these legal standards, the mail service used by GameFly is indisputedly "like," "functionally equivalent to" and "similarly situated to" the mail service used by Netflix notwithstanding any differences in the value of the DVDs or the average length of haul between distribution center and subscriber. Both companies use First-Class Mail to ship DVDs in mailers to and from subscribers. Both companies' DVDs are small and light enough to be mailed in lightweight mailers as one-ounce letters if the Postal Service processes the pieces in a non-destructive fashion. And Postal Service officials themselves have conceded the functional equivalence between the mail service provided to Netflix and the service provided to other DVD rental companies.

Answer of Gamefly Inc. to Motion of USPS to Postpone Hearing, PRC Docket No. C2009-1 (June 8, 2010) at 12.

The Postal Service does not completely comprehend how this labeling fits into even GameFly's description of the legal standards applicable to determination of its discrimination claims under section 403(c). Considering GameFly's posture as a mailer, however, its concern in this complaint action is patent. Relevant distinctions between GameFly and Netflix are a matter of record evidence; Postal Service witness Barranca emphasized one salient difference that has considerable bearing on GameFly's Complaint:

> GameFly does not even attempt to mail at the same rate and classification as Netflix. Rather, GameFly chooses to enter its DVDs and receive them as return traffic as First-Class Mail flats. By placing protective material in the flats pieces, furthermore, GameFly increases the weight of the pieces beyond one ounce, so that it must pay the more expensive second-ounce flat rate. In flats processing, moreover, GameFly has taken special efforts to ensure that its DVDs are not processed manually, but rather are processed on flats automation equipment. GameFly has worked with the Postal Service to ensure that result, because, in its estimation, such

> processing best meets its objectives of minimizing breakage and avoiding theft and loss.

USPS-T-1, at 9.

In light of the broad language in 39 U.S.C. §3662(a) creating Commission jurisdiction in complaints, pointing out this obvious deficiency in GameFly's situation is hardly dispositive. Yet, simply put, under the standards governing the jurisdictional doctrine of standing in federal law, GameFly would lack the requisite posture to challenge the Postal Service's conduct under section 403(c), based upon the bare facts it has alleged.[25] As explained by the court in *UPS Worldwide Forwarding*, the Supreme Court identifies three elements necessary to support standing: 1) "the plaintiff must have suffered an 'injury in fact'—an invasion of a legally protected interest which is (a) concrete and particularized, and (b) actual or imminent, not conjectural or hypothetical;" 2) "there must be a causal connection between the injury and the conduct complained of…;" and 3) "it must be likely, as opposed to merely speculative, that the injury will be redressed by a favorable decision." *Id.* at 625-26 (citations omitted). In this case, GameFly's injury is hypothetical: GameFly argues that it does not mail at the same rates as Netflix, but, if it did, it would not receive the same treatment. GameFly's causal connection with discrimination is theoretical, based on a constructive interpretation of Postal Service practice and policy: GameFly argues that the Postal Service's policy of deferring to local judgment and decision-making has "denied" GameFly equal treatment, and that the Postal Service has, in effect "refused" to give GameFly comparable service. Finally, in spite of the allegations

[25] See the extended discussion of standing in *UPS Worldwide Forwarding Inc. v. United States Postal Service,* 66 F.3d at 625-31

embodied in its complaint, GameFly has not indicated that, if it were to be afforded equal treatment, it would abandon its own choice of mailing at flats rates for the objectives that option provides.[26] In this regard, GameFly has not responded to the Postal Service's offer to achieve GameFly's stated objective under conditions identical to those offered Netflix, or alternative conditions that might be negotiated.

The Postal Service submits that, judged by these standards, GameFly's Complaint should fail for lack of standing.[27] These considerations should also inform the Commission's consideration of the other claims of unlawful discrimination or preference that GameFly articulates in its Memorandum, beyond the issue of whether the difference in processing operations that GameFly alleges discriminates unlawfully in favor of Netflix. In other words, would 1) a reclassification of Netflix mail as machinable, 2) engaging with GameFly's representatives in a fashion similar to that promoted by Netflix's representatives in the field, or 3) not "shrinking" from exploring a higher rate for Netflix mail, redress GameFly's Complaint? The same logic that would deny GameFly's standing to challenge local processing decisions under section 403(c)

[26] Benefits GameFly's current business model provides include Confirm scans early in returning mailpieces' trip through the mail (used to trigger mailing of the next game DVD on a customer's preference list) and the avoidance of manual processing that GameFly associates with avoidance of theft; these would be lost if it chose to use the mail how Netflix does.

[27] Judging by GameFly's previous arguments (uniformly applying the 'damned if you do and damned if you don't' standard), the Postal Service anticipates that GameFly will argue that the Postal Service has "waived" its opportunity to challenge standing by not moving to dismiss earlier in the case. In this respect, the Postal Service notes that, under federal precedents, it is well-settled that a jurisdictional defect like standing may be raised at any stage of a proceeding.

should apply to these elements under the Supreme Court's standards of injury in fact, causation, and effectiveness of remedy.

If the Commission determines not to dismiss the Complaint for lack of standing, however, the Commission should consider the similarities, as well as the differences, between GameFly, on one hand, and Netflix and Blockbuster, on the other, in evaluating the reasonableness of the Postal Service's conduct under section 403(c). Such consideration, rather than regarding "similarly situated" as the second stage of a checklist in GameFly's outline of applicable legal standards, represents the most pertinent use of a comparison between the two mailers. GameFly agrees that such differences are proper considerations in evaluating the reasonableness of discrimination.[28]

We explain below how GameFly's own characteristics and behavior contribute to the justification and reasonableness of the Postal Service's conduct. The Postal Service has submitted substantial evidence, including testimony from its operations managers, establishing the logic and reasonableness of the distinctions about which GameFly complains. It should be emphasized that the Postal Service does not concede GameFly's version of the facts surrounding mail processing of DVDs in the field, or GameFly's representations about its own behavior and capabilities. These should be evaluated in light of the entire record, including Postal Service testimony rebutting and illustrating weakness and inconsistency in GameFly's allegations.

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[28] May 14 Answer, at 5 ("Differences between two customers certainly may be relevant to the separate issue of whether the Postal Service's discrimination has a *rational* basis, particularly in terms of the Postal Service's cost of service.") June 8 Answer, at 13.

D. The Commission and Courts Have Applied a Practical, Balanced Standard in Evaluating Discrimination Claims Under 39 U.S.C. §403(c)

Courts and the Commission have taken a practical, fact-based approach to assessing discrimination claims under 39 U.S.C. § 403(c). Courts that have considered such claims have started by recognizing that, by its plain terms, section 403(c) does not prohibit discrimination or preferences; rather, it prohibits only "undue or unreasonable" discrimination or preferences. *UPS Worldwide v. United States Postal Service, supra,* at 634. In assessing reasonableness, the courts have looked to the logic of the Postal Service's justification for differential treatment among mail users, as well as the relationship of such treatment to the Postal Service's responsibilities and authorities under the statutes and regulations that govern its conduct.

1. Judicial Precedent Has Recognized the Postal Service's Broad Responsibilities and Discretion in Evaluating Reasonableness under Section 403(c)

In *UPS Worldwide, Inc. v. United States Postal Service*, the court of appeals considered challenges to a Postal Service program authorizing contract rates for international mail (ICMs). Postal Service regulations specified that mailers would be eligible to qualify for individualized rate contracts, if they were capable, on an annual basis, of mailing at least one million pounds of international mail or paying at least two million dollars in postage. UPS challenged the ICM program arguing, *inter alia*, that it conflicted with section 403(c)'s prohibition against discrimination. The District Court agreed with UPS,

and found that the ICM program conflicted with several provisions of the Postal Reorganization Act (PRA), including section 403(c).

The Court of Appeals for the Third Circuit reversed, finding that the feature of the ICM program that distinguished mail users on the basis of their capabilities to bring the Postal Service international business was a reasonable basis for differentiating among potential customers. In addressing UPS Worldwide's claims, the court considered the statutory scheme of the PRA, in which the Postal Service was given broad authorities to function in commercial markets like a business. *Id.* 624-25. The court also considered the distinct characteristics of service in international mail markets, where costs for services to numerous countries varied by country and type of service, but published rates were uniform. *Id.* at 31. The District court had concluded that the criteria for participation in the ICM program, which differentiated mailers on the basis of their capabilities, rather than actual mail volume provided, discriminated against small-volume mailers. The court of appeals, however, accepted the Postal Service's reasoning which relied on the costs and infeasibility of negotiating and administering ICMs with smaller mailers, as well scale economies, which favored larger mailers. *Id.* at 632. The Court stated:

> Despite the reasons for implementing the program, the Postal Service determined that it would not be feasible to offer ICM service to everyone "regardless of size or mailing patterns." *Id*. at 30653. The Postal Service estimated substantial costs to negotiate and implement the ICM agreements; expenses were high enough so that "for all but the largest volume customers, those costs in many instances could be greater" than the Postal Service earned from the ICM program. Furthermore, the Postal Service expected to benefit from economies of scale generated by large-volume customers that would not occur with smaller mailers. As it noted,

> "[I]ncreased volumes amplify the beneficial effects of flexible pricing." Because ICM agreements vary depending on the level of services required by individual customers, ICM rates may be higher, lower, or the same as ordinary public rates.

Id. at 633 (internal citations omitted). The Court also considered the Postal Service's business rationale for focusing on capability, rather than performance, and for excluding smaller mailers with lower capabilities. Under the Postal Service's reasoning, requiring eligibility established by actual volumes, rather than capabilities, would have the effect of deterring, as opposed to attracting, new business. The Court concluded:

> We believe this provides a logical and reasonable explanation for the Postal Service's business decision. UPS does not contend that the Postal Service's explanation fails to pass muster in an economic sense; it merely argues the Postal Service does not have the authority to make such business judgments. But Congress repeatedly indicated that a primary purpose underlying the PRA was to require the Postal Service to discard its system of political patronage and bureaucratic decision-making in favor of modern business practices. *See infra* part IV.D. We see nothing in the PRA that prevents the Postal Service from innovative attempts to increase its business and profits, as long as it stays within the bounds of the relevant statutes.

Id. at 634.

In *Currier v. Henderson,* 190 F.Supp.2d 1221 (W.D. Wash. 2002), the district court considered challenges by homeless persons to the Postal Service's policies and regulations that established restrictions on post office box rental, availability of free post office box service, and general delivery service. Plaintiffs argued that these restrictions, which limited availability of these services for homeless persons, violated section 403(c)'s prohibition against unreasonable

discrimination. In describing the Postal Service's rationale for differential treatment, in connection with plaintiffs' constitutional claims, the court stated:

> First: The distinction between customers who receive no-fee postal boxes and those that don't is reasonable. The relevant postal regulations that govern the no-fee boxes make it clear that only residents who have a physical residence or a business location at a fixed delivery point are eligible for the Group E Rate program. (Dorsey Decl. Ex. B, Postal Bulletin 21975.) The Group E Rate service is grounded in rational considerations of eliminating the disparity of service between "those customers *with fixed home or business locations* to which the Postal Service provides carrier delivery service and those to which carrier delivery service is not provided for some operational reason." (Dorsey Decl. ¶ 9) (Emphasis added.) Just because the Postal Service chose to minimize certain disparities does not mean that it is required to eliminate them all, particularly between people who are not similarly situated. Second: As the Postal Service makes clear, General Delivery is an expensive option that requires a transaction with a person at a counter. (Dorsey Decl. ¶ 8.) Providing this service at all 32 Seattle locations has the potential to increase costs as well as to complicate investigations of illegally shipped material. (Decl. of Eugene Broom ¶ 6.) The Postal Service could reasonably decide to provide this service only at one branch in a jurisdiction.

Regarding these reasons, considering Plaintiffs' claims under section 403(c), the court stated:

> The Court holds that under the facts of this case, the statute does not impose upon the Postal Service a higher standard than that demanded by the Constitution. Since the regulations have a rational relationship with the legitimate goals of providing efficient and economical service and have satisfied constitutional concerns, this Court finds that the requirements of 39 U.S.C. § 403(c) are met.

Id. at 1231.

This decision was upheld by the Ninth Circuit Court of Appeals in *Currier v. Potter,* 379 F3d 716 (9th Cir. 2004). Discussing the Plaintiff's constitutional claim, the court stated:

> In this case, the Postal Service's limitation of general delivery service is a rational response to the inefficiencies and increased costs that would result from expanding general delivery to branch offices. *Cf.* *Greenburgh,* 453 U.S. at 133, 101 S.Ct. 2676 (Postal Service's concern with maintaining efficient operations provided reasonable basis for denying First Amendment claim). Similarly, the Service's cost-driven decision to offer no-fee boxes only to customers with physical addresses who are denied carrier service is a reasonable attempt to eliminate some disparities between customers who receive carrier delivery and those who do not. *See Geduldig v. Aiello,* 417 U.S. 484, 495, 94 S.Ct. 2485, 41 L.Ed.2d 256 (1974) (state may properly choose partly to remedy problem); *Dandridge v. Williams,* 397 U.S. 471, 487, 90 S.Ct. 1153, 25 L.Ed.2d 491 (1970) (equal protection does not require government to "attack[ ] every aspect of a problem"). We are therefore satisfied that the Service's regulations do not violate equal protection.[29][

In *Egger v. United States Postal Service,* 436 F.Supp.138 (W.D.Va.1977), the District court considered a claim under section 403(c) brought by a university student who argued that the Postal Service's delivery policies discriminated unreasonably in favor of families living in university-owned apartments and single students living in private housing, and against single students living in university apartments. The Postal Service argued that the challenged distinctions were rationally related to the cost effective and efficient delivery of the mail. In this

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[29] Currier's statutory claim under 39 U.S.C. § 403(c) essentially rehashes his equal protection challenge, contending that the Service's regulations unreasonably discriminate against the homeless. However, the statute expressly contemplates that the Service will make reasonable distinctions among users of the mail system. *See UPS Worldwide Forwarding, Inc. v. United States Postal Serv.*, 66 F.3d 621, 624 (3d Cir.1995); *Egger v. United States Postal Serv.,* 436 F.Supp. 138, 142 (W.D.Va.1977); *see also Grover City v. United States Postal Serv.,* 391 F.Supp. 982, 986 (C.D.Cal.1975) ("The Postal Service's delivery regulations are not unreasonably discriminatory because the distinctions made by the regulations are reasonably related to the effectuation of the pertinent objectives of the Postal Reorganization Act, which are provision of efficient mail delivery services at reasonable costs."). Because we conclude that the challenged regulations are rationally justified and thus do not violate equal protection, we are satisfied that the Service has also not breached its statutory mandate. *Id.*

regard, the Postal Service reasoned that, based on experience, the tendencies of single students to move more frequently than married students caused delivery to single students to be more expensive. Consequently, its decision to allow delivery to single students only via bulk delivery, rather than individual delivery, at their university-owned addresses saved costs that would be associated with having to adjust to situations where the single-students had moved. The court agreed. It stated:

> The court concludes that the difference in delivery methods to school-owned apartment complexes occupied entirely by unmarried students and those occupied entirely by married students accompanied by their families is rationally related to the achievement of the Postal Service's statutory goal of providing economical and efficient mail delivery. The court agrees with defendants that in postal delivery policy, distinctions and policy differences must often be based on the general differences between identifiable groups of mail recipients. While unmarried students residing at the Lambeth Field complex are easily identified as a group, since the complex is occupied exclusively by unmarried university students, other unmarried students living throughout the Charlottesville area are not as identifiable and are certainly not amenable to delivery in a group because they do not all live in a specifically defined location such as Lambeth Field. The court concludes that the discrimination in delivery methods between unmarried students occupying school-owned housing as a group and similar students occupying disparate housing units in the area is rationally related to the achievement of the Postal Service's goal of economical and efficient mail delivery.

Id. at 143.

In *Bovard v. United States Post Office,* 47 F.3d 1178 (10th Cir. 1995), the court of appeals affirmed a lower court decision declining to find unreasonable under section 403(c) a decision by a postmaster to change delivery service to plaintiff's business. The change was justified by the Postal Service, based on experience of past conflict, as a measure taken to avoid future conflict between

the plaintiffs and the morning mail carrier. While the court of appeals affirmed the District court's dismissal on the basis of lack of jurisdiction, it stated:

> Were we to consider the merits of the plaintiffs' discrimination claim, we would reject it in any event. The postmaster's decision to change the time of the plaintiffs' mail delivery was a reasonable decision, rationally related to the effectuation of the Postal Service's statutory objectives of providing efficient delivery of the mails at a reasonable cost. *See* 39 U.S.C. 101; *see also Ludewig v. Wolff,* 492 F.Supp. 1048, 1049 (S.D. Tex.1980); *Egger v. United States Postal Serv.,* 436 F.Supp. 138, 142 (W.D.Va.1977); *Grover City v. United States Postal Serv.,* 391 F.Supp. 982, 986 (C.D. Cal.1975).

Id.

In *Ludewig v. Wolff,* 492 F.Supp. 1048 (SD Tex 1980), twenty-six individual postal customers challenged, under section 403(c), the decision of a postmaster to renumber their mailboxes without their consent. The District court upheld the Postal Service's decision. The court stated:

> Although no statute or regulation specifically allows the Postmaster to renumber the route, the Postal Service is given broad latitude in making the decisions necessary to the efficient and effective operation of the postal system. *Buchanan v. United States Postal Service,* 508 F.2d 259, 263 (5th Cir. 1975); *Martin v. Sloan,* 432 F.Supp. 616, 617 (W.D.N.C.1977); *see* 39 U.S.C. §§ 101, 401(10), 403(a). The Postmaster has sought to provide more economical and efficient service by renumbering the boxes. This objective is accomplished by reducing the time necessary for the letter carrier to sort and deliver the mail. The Postal Service contends that the Postal Reorganization Act of 1970, 39 U.S.C. § 101, et seq., provides that such action is "necessary" and proper to the performance of effective, efficient, and economic postal service. *See* 39 U.S.C. §§ 401(10), 403(b)(1). The Court is of the opinion that the Postal Service's interpretation of these statutes are controlling since it is not plainly erroneous or inconsistent with the statutes. *Egger v. United States Postal Service*, 436 F.Supp. 138, 142 (W.D.Va.1977); *see Bowles v. Seminole Rock & Sand Co.*, 325 U.S. 410, 65 S.Ct. 1215, 89 L.Ed. 1700 (1945). The Court agrees that the restructuring of the manner of delivery may be necessary to achieve efficient postal service. *See Egger v. United States Postal Service*, 436 F.Supp. 138, 142 (W.D.Va.1977) (change in delivery

> policy to unmarried students); *Eldridge v. United States Postal Service*, Civ. No. 75-15285 (M.D.Pa.1976) (change in postal address from Maryland to Pennsylvania). Accordingly, the Court concludes that the Postal Service's renumeration of the rural mailboxes to provide more effective service is reasonably related to the Act, and permissible thereunder. *Grover City v. United States Postal Service*, 391 F.Supp. 982, 986 (C.D.Cal.1975).
>
> Additionally, the Postal Service's delivery regulations, as well as their application by the Postmaster herein, are not unreasonably discriminatory because the distinctions made by the regulations are reasonably related to the effectuation of the pertinent objectives of the Postal Reorganization Act, which includes the efficient delivery of mail at reasonable costs. *Grover City v. United States Postal Service*, 391 F.Supp. 982, 986 (C.D.Cal.1975); 39 U.S.C. § 403(c); *see Egger v. United States Postal Service*, 436 F.Supp. 138, 142 (W.D.Va.1977). The Court further finds that the Postmaster properly complied with the postal regulations by numbering the boxes sequentially in the order they are served.

Id.

In *Mail Order Association of America v. United States Postal Service,* 2 F.3d 408 (D.C. Cir. 1993), Dow Jones & Co. challenged the Postal Service Governors' approval of a Commission recommended decision in Docket No. R90-1 in which the Commission declined to zone the editorial pound charge in the rates for Second-Class Mail. Dow Jones and others, during the administrative phase of the case, had argued that failure to zone the pound charge was inefficient and conflicted with economic principles embodied in the PRA. The Commission rejected these claims, electing not to zone in compliance with its interpretation of the mandate in 39 U.S.C. § 101(a) that the Postal Service "bind the nation together." Among other claims, Dow Jones argued on appeal that the Commission's decision conflicted with section 403(c) and

discriminated against “long-haul” publishers, in favor of “short-haul” publishers. Regarding this claim, the court stated:

> The question then, is whether the Commission was arbitrary in its ultimate trade-off between the cost considerations that pointed toward zoning, and the competing values that it ultimately favored. Any such arbitrariness would presumably violate 39 U.S.C. 403(c)'s prohibition of “undue or unreasonable preferences.”
>
> The refusal to zone indeed appears unsupported by any cost principle-fully allocated, marginal, incremental, etc. Such a divergence from cost, Dow Jones argues, dilutes the incentives for long-haul publishers to engage in practices that would save the Postal Service money, such as “dropshipping” near the mail's destination. As we noted in connection with presorting discounts and shape differentials, divergence from cost tends to send users inaccurate signals-ones that may lead mailers to adopt distribution strategies that are more costly than necessary. Furthermore, unzoned rates could harm the Service by encouraging high-volume mailers capable of dropshipping to shift their business away from the Postal Service altogether.

Id. at 435-436 (internal citations omitted).

Notwithstanding the court’s acknowledgement of the logic of the petitioners’ argument that the decision violated economic principles, the court upheld the Commission’s recommendation on the basis of its policy reasoning. The court stated:

> By raising the cost of sending such periodicals across the nation to potentially prohibitive levels, a zoned EPC would interfere with long-distance transmission of information and therefore could be viewed as inconsistent with the congressional purpose of “binding the nation” together. That is a value that Congress favored strongly-to the point of mandating nonzoning for first-class mail. *See* 39 U.S.C. § 3623(d). Thus, in light of § 101(a), we have no basis for calling arbitrary and capricious the Commission's decision to adopt a rate structure favoring mailers who send their publications long distances. Furthermore, because it seems clear that the Commission would have reached the same result under § 101(a) even without considering § 3622(b)(8), we sustain its decision rather than remanding.

Id. at 437 (internal citations omitted).

2. The Commission Has Taken a Logical, Consistent Approach to Evaluating Discrimination Claims under Section 403(C)

In addition to the instances above where courts have considered the application of section 403(c) to challenges to Postal Service operations and business policies, as well as the Commission's consideration in the context of its rate and classification recommendations, on several occasions the Commission has addressed the discrimination prohibition. As with the judicial opinions, the Commission's determinations have been closely tied to the specific facts before it.

In Docket No. R77-1, the Commission considered a Postal Service proposal to create a separate, lower rate for Citizens Rate Mail (CRM). PRC Op. R77-1, Docket No. R77-1, Vol. I, at 180-225 (May 12, 1978). CRM would be a category of First-Class Mail available only to individuals for use with personal correspondence, but would not be available to businesses for commercial use. *Id.* at 180-82. The operational justification for the separate rate depended on CRM having status as a category that could be deferred at delivery under appropriate conditions. Various policy reasons were advanced to justify CRM, including the Postal Service's determination that it would promote the policies embodied in 39 U.S.C. § 101(a). *Id.* at 184, 188-91. The proposed lower rate for CRM was based, in part, on not assigning to the category fixed costs associated with the delivery function. These "service related costs" (SRC) were assigned in

Docket No. R77-1 to so-called "preferential" categories of mail that could be deferred at delivery, according to the Postal Service's service standards.[30]

Among several other reasons, the Commission declined to recommend CRM on the basis that it would conflict with the anti-discrimination prohibitions in section 403(c). The Commission concluded that a rate distinction between CRM and other single-piece First-Class Mail must be based on an actual service distinction. The Commission found that the service distinction relied on by the Postal Service to propose CRM was not realistic, and that, in practice, CRM would not receive deferral at delivery. *Id.* at 194-99. The Commission also failed to find that CRM was justified by the distinction between personal and business correspondence that it embodied. In this regard, the Commission stated:

> We likewise find no substantial distinction in law, usage, or common practice which would so distinguish the first-class personal correspondence of citizens from business correspondence as to warrant the claim implicit in the CRM proposal that special regard must be accorded the former in its ability to "bind the Nation together." As between these two forms of correspondence, we have no basis for designating one over the other as more important in this regard; rather, we can only conclude that each serves a valuable and, indeed, indispensable function.

Id. at 200-01.

[30] Service-Related costs had a controversial history in Docket Nos. R77-1 and R80-1. Originally proposed by the Postal Service and adopted by the Commission in Docket No. R77-1, consistent with earlier court decisions by the D.C. Circuit Court of Appeals, the concept was repudiated by the Postal Service in Docket No. R80-1, yet recommended by the Commission in that proceeding. Legal challenges to Service Related Costs in the Court of Appeals for the Second Circuit led to a conflict between the Second and DC circuits over whether proper interpretation of the PRA mandated the "reasonable assignment" of fixed costs represented by SRC. Ultimately, the Supreme Court agreed with the Second Circuit that SRC were not required to be assigned. Subsequently, the cost allocation practice was abandoned by the Commission.

In accordance with these findings, the Commission declined to recommend CRM, noting also that a favorable recommendation would constitute unreasonable discrimination under section 403(c).

The Governors of the Postal Service approved the Commission's recommended decision. On appeal, the Court of Appeals for the District of Columbia Circuit upheld the Governors' decision, but did not rest its affirmance on the Commission's reasoning regarding section 403(c). Rather, the court affirmed on the basis of the Governors' reservations about the record support for the CRM proposal. The court stated:

> In sum, we affirm the Governors' order which accepts the PRC recommendation to reject the CRM proposal. However, we, like the Governors, do not rest our decision on the PRC classification conclusion. Rather, we agree with the Governors and the PRC that the wide range of uncertainties in the record surrounding the CRM proposal rendered rational and informed application of the ratemaking provision a near impossibility. However, we emphasize that our decision is strictly limited to the CRM proposal and the record in this ratemaking proceeding. Our affirmation of the PRC's rejection of this CRM proposal does not imply that future CRM proposals, supported by a fuller, more substantial record, should be rejected. By contrast, we echo Chairman DuPont's encouragement to the Postal Service to restudy the CRM concept and offer a new proposal in future proceedings.

Id. at 424.

In Docket No. MC79-3, the Commission considered section 403(c) in connection with proposals to create a rate distinction between "Red Tag" and "Non-Red-Tag" Second-Class Mail. GameFly relies principally on this precedent to support its claims of discrimination in the instant Complaint. GameFly Memorandum at 50-51.

Under postal regulations and practice in effect when Docket No. MC79-3 was initiated, Red-Tag status was available to publications published weekly or more frequently and containing news of general public interest. Red Tag mail received preferential service in relation to Non-Red Tag publications, since Red Tag mail benefitted from a priority in delivery operations. Furthermore, in Docket No. R77-1, as explained above, the Commission adopted a costing methodology in which part of the fixed costs of delivery were assigned to classes of mail that enjoyed a delivery priority in Postal Service service standards. Those "preferential" classes included Second-Class Mail.

When the Commission's costing approach in Docket No. R77-1 was challenged in the court of appeals, the court noted the disparity created by the assignment of Service Related Costs to Second-Class Mail, while priority service distinctions between Red-Tag and Non-Red-Tag publications existed within Second-Class.[31] This concern about the discrimination embodied in the Commission's cost allocation methodology played a critical role in the

[31] In *National Association of Greeting Card Publishers v. United States Postal Service*, 607 F2d 392, at 409 (DC Cir. 1979)(footnote omitted), the court stated:

> Finally, we do find substance to the claim of American Business Press, Inc. (ABP), an association of publishers of specialized business publications. Despite the fact that preferential or "red tag" second-class mail makes up only 40 percent of all second-class mail, the PRC assigned to all second-class, both preferential and nonpreferential, the service related costs caused by providing preferential service to red tag. We agree with ABP that assignment of service related costs to mail not receiving preferential service raises serious concerns of discrimination. In our preceding discussion, we have accepted, at least for this case, the PRC's adoption of a model based on a dichotomy between preferential and nonpreferential mail, even though that distinction may not entirely reflect actual service priorities. But the failure to distinguish in the assignment of costs between preferential and nonpreferential mail goes contrary to the PRC's own model.

Commission's recommendation in Docket No. MC79-3 to create separate subclasses and separate rates for the Red Tag and Non-Red-Tag categories. The rate differential that the Commission recommended for the two categories was based on the assignment of service related costs. The Commission found no other differential between the attributable costs of Red-Tag and Non-Red-Tag on the record of Docket No. MC79-3. PRC Op. MC79-3, at 33-39.

GameFly relies principally on two conclusions in the Commission's Red Tag decision. First, the Commission stated:

> Based on this record, we conclude that it is unduly discriminatory for non-red-tag mailers to pay the same rate that red-tag mailers pay, and receive a lesser quality service. We find this especially discriminatory when regular rate second-class mailers cannot, even for an additional fee, obtain this expedited service.

Id. at 11. GameFly Memorandum at 50.

Second, GameFly notes that the Commission criticized the eligibility requirements for Red Tag embodied in Postal Service regulations. *Id.* GameFly quotes the Commission's conclusion that there was "no rational relationship between the present eligibility requirements for red-tag service, and a mailer's need for the expedited delivery that red-tag offers." PRC Op. MC79-3, at 12. GameFly Memorandum at 50. GameFly unilaterally expands this conclusion by itself concluding that "[i]n doing so, the Commission recognized the fundamental principle that services can only be considered non-discriminatory if they are made available to similarly situated parties."[32] *Id.* at 50-51. GameFly further

[32] This expansion, contrary to actual decisions about substantial similarity, turns the definition on its head and expands the term well beyond reason or practical applicability. If any two mailers of a single price must thereby be deemed substantially similar, the legal significance of the term would be obliterated. Of course that may matter little to the

quotes the Commission's statement that the distinctions in cost characteristics represented by Red Tag and Non-Red-Tag mail constituted undue discrimination unless they were reflected in separate rates for the two categories. *See* PRC Op. MC79-3, at 19; GameFly Memorandum at 51.

Regarding the Commission's first conclusion described above, the Postal Service notes that the Commission's finding of unlawful discrimination as a result of two mailers paying the same rate for different service is not supported by the facts established on the record of this proceeding. Not only has GameFly never paid the single-piece or automation First-Class Mail letter rates that Netflix pays, but it has deliberately elected to mail under an entirely different classification for First-Class Mail flats. *See* GameFly Response to USPS/GFL-48 (confirming that "GameFly [did not] mail any DVDs as First-Class Mail single ounce letters" and that "GameFly has always sent and received its DVD mailers as single-piece First-Class flats"); Tr. 5/890. Furthermore, the evidentiary record supports the conclusion that GameFly's choice to mail at the flats rate is influenced by factors other than its hypothetical argument and conclusion that it would not receive comparable service, if it were to mail at the letter rate. Finally, even if GameFly's hypothetical argument, including its unsupported contention that it has been "refused" comparable treatment were accepted, GameFly has not established that differential treatment between GameFly and Netflix constitutes unreasonable discrimination.

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outcome of GameFly's complaint given that Netflix and GameFly do not use any single price or group of prices owing to their letter versus flats mailers.

Regarding, the Commission's second conclusion, which GameFly projects to its own conclusion, the Postal Service notes that the Commission's findings do not lead to the result implied by GameFly's conclusion. While the Commission recommended a classification with new conditions that gave any publication the opportunity to elect Red Tag service at a higher rate, it did not ultimately conclude that the existing criteria were entirely discriminatory. It found that the 'news of general public interest' criterion did not withstand scrutiny, but it made no similar finding that the frequency criterion could not be sustained. The Commission stated:

> Although we are troubled by this time frequency requirement, we stop short of making a finding of legal, undue discrimination. That issue is before the Court of Appeals, and since that question is not required by our action in this case, we will not preempt the court's decision. Absent our finding of cost differential between red-tag and ordinary service, and consequently a rate differential, it is problematical whether we would be recommending any change in the red-tag eligibility criteria.

PRC Op. MC79-3, at 72. In other words, the Commission acknowledged that, in the circumstances it was reviewing, there might exist, a reasonable basis for concluding that "equal service" need not be extended to two mailers paying the same rate, if distinctions between the mailers gave rise to reasonable differences in operations.

Finally, regarding the "cost differential" cited in the previous quote, it must be noted that the Commission was referring to the difference embodied in allocation of fixed costs under the Commission's Service Related Cost methodology in Docket No. R77-1, and the Commission's formulation of a rate differential in Docket No. MC79-3. As noted above, the Commission found no

other difference in costs between Red Tag and Non-Red Tag mail in that docket. By contrast, no similar cost allocation discrepancy, such as that represented by Service Related Costs, has been established on the record of this proceeding.

In Docket No. C87-2, the Commission considered a complaint brought pursuant to 39 U.S.C. § 3662 by the American Newspaper Publishers Association (ANPA). PRC Op. C87-2, Docket No. C87-2 (Dec. 16, 1988). ANPA challenged Postal Service regulations and policy controlling the availability of detached address labels (DALs) for mailing Third-Class saturation mail. Under Postal Service regulations, mailers who qualified for saturation mailings (i.e., with at least 90 percent coverage of addresses on a carrier route) could utilize labels separate from the saturation mailpiece, without payment of any extra charge beyond the appropriate Third-Class rate. Among other reasons, ANPA contended that the DAL practice should be revised to charge additionally for the attached label, because it constituted a separate mail piece that should be individually rated. ANPA also argued that the DAL practice amounted to unlawful discrimination under section 403(c).

The Commission found that DALs did not violate policies embodied in the PRA or the Domestic Mail Classification Schedule (DMCS), and it declined to recommend that DALs be separately classified in the DMCS and charged a separate rate. *Id.* at 1. ANPA had argued that the saturation requirement was discriminatory, since it favored the Postal Service's largest customers, who were uniquely in a position to meet the 90 percent requirement. *Id.* at 40-41. ANPA

also contended that the "free" delivery of the separate mailpiece amounted to unlawful discrimination. *Id.* at 41.

The Commission rejected ANPA's discrimination argument, finding a rational relationship between the Postal Service's operational objectives and the DAL requirements. The Commission stated:

> Our review of the record reveals no undue discrimination in the saturation requirement. Postal regulations are replete with various minimum or maximum requirements; the system would be unworkable or unacceptably inefficient if none were applied. This is not to say that eligibility criteria cannot be discriminatory on their face or by their operation, but our role to examine whether a requirement which distinguishes between or among mailers unduly discriminates. In this sense, we find that while DMM §661.3 restricts eligibility to those mailers with the defined penetration, the thresholds the Service has set for the respective types of routes appear to be reasonably supported in operational evidence to date.

Id. at 41-42. Regarding ANPA's argument that DALs should be defined as a separate piece of mail in the DMCS, the Commission concluded:

> In addition to general considerations of management flexibility, we find that the detached label practice complained of here is fully consistent with postal policies and provisions in the DMCS. The record clearly demonstrates that the primary purpose of the procedure is to facilitate postal handling of third-class saturation flat mailings, and, as currently deployed, creates net efficiencies for the Postal Service and mailers alike. In light of this, defining detached address labels as separate pieces of mail for purposes of calculating postage would be inappropriate in all significant ratemaking, classification and practical respects.

Id. at 52.

It is worth noting that a significant issue in Docket No. C87-2 was the validity of the Postal Service's long-held contention that, rather than costing more, as contended by ANPA, use of DALs actually resulted in more efficient operations. In this regard, the Commission found persuasive and relied upon

Postal Service testimony that did not reflect a study of operations based on data collection in the field. Rather, the Postal Service's sponsored evidence reflected qualitative conclusions based on a time-motion analysis of the pertinent operations. *Id.* at 30-40. This approach, of course, comports perfectly with the evidence in this docket.

3. Specific Facts Established on the Record Should Control Evaluation of Reasonableness Under GameFly's Complaint

The above-discussed precedents provide considerable guidance in understanding the appropriate legal standard for evaluating claims of discrimination under section 403(c). Under these precedents, all that needs to be established in record evidence before the Commission is a reasonable nexus between the alleged discriminatory conduct and the Postal Service's legitimate purposes and authorities under controlling law and statutes. In this regard, if a clear link can be established through record evidence between the differences challenged and the overall goals of efficiency and effectiveness of operations and service, a conclusion of reasonableness is supported and sustained. As noted in *Mail Order Association of America v. United States Postal Service,* however, efficiency alone is not paramount, and sufficient policy justification can overcome claims of illegal discrimination. Furthermore, the decisions described above show that courts acknowledge broad discretion in the Postal Service to determine its own practices. As the court in *UPS Worldwide Forwarding* stated:

> As with the terms "fair" and "equitable" in § 101(d), we find it difficult to define the contours of what constitutes "undue or unreasonable" discrimination or preferences. We note that other courts, when confronting this section, have accorded postal authorities broad latitude. In *Mail Order Ass'n of America v. United*

States Postal Service, 2 F.3d 408, 434 (D.C.Cir.1993), magazine publishers challenged the Postal Rate Commission's decision not to adopt a "zoned" second-class mail rate, i.e., a rate that would increase with distance. Because the Commission's decision had not violated any specific rate provision of the PRA, the Court of Appeals for the District of Columbia reasoned that:

> The question, then, is whether the Commission was arbitrary in its ultimate trade-off between the cost considerations that pointed toward zoning, and the competing values that it ultimately favored. Any such arbitrariness would presumably violate 39 U.S.C. § 403(c)'s prohibition of "undue or unreasonable preferences."

Id. at 435-36. The court noted that "[t]he refusal to zone indeed appears unsupported by any cost principle." *Id.* at 436. Nevertheless, the court ultimately held that, because the Commission had valid reasons for its decision, it had not violated § 403(c). *Id.* at 437.[33] Similarly, as we noted *supra* in part IV.B., the Postal Service had equally valid reasons for its decision to create the ICM service.

The Commission's own precedents are equally instructive. As the Commission noted in Docket No. R77-1 regarding the CRM proposal:

> Section 403(c) is no different in its prescription of "undue or unreasonable discrimination." Thus the mere fact of a difference in

[33] Other courts have reached similar conclusions. In *Aimes Publications, Inc. v. United States Postal Service,* Civ. A. No. 86-1434, 1988 WL 19618, at *6 (D.D.C. Feb. 23, 1988), the court noted the Postal Service's enforcement of its second-class statutory rules apparently was "at best, uneven," but it found no violation of § 403(c). The court stated that "[t]ypically, the court[s] have given the Postal Service broad discretion in administering the classification scheme, which necessitates differentiating among users." *Id.* at *7 n. 13. And in *Egger v. United States Postal Service,* 436 F.Supp. 138 (W.D.Va.1977), a student challenged a Postal Service policy that provided a different level of service to single students living in university housing than that provided for married students. In upholding the different service levels, the court noted:
While it is obvious that [§ 403(c)] prohibits undue or unreasonable discrimination among users in the provision of delivery services, it is also equally obvious that the Postal Service may provide different levels of delivery service to different groups of mail users so long as the distinctions are reasonable. The goal sought by the Postal Service in the instant case by their discrimination is the efficient and economical delivery of the mail. The goal is legitimate and the only question before the court is whether the distinctions between the three groups are rationally related to the achievement of the goal.

> rate among customers in the same class is not per se unlawful. What is required, however, is that some material distinguishing characteristic exist either in the segment of customers constituting the class or subclass, or in the form of the service to be provided such segment, so as to warrant the differential.

PRC Op. R77-1, Vol. 1, at 195. In this regard, in its inquiry into GameFly's allegations under section 403(c), the Commission must carefully evaluate the substantial, reliable evidence on the record that the Postal Service's practices regarding the processing of DVD mail are based on material distinguishing characteristics of that mail, its processing environment, and factors animating postal officials' decisions about how it should be handled and processed that support the conclusion that any differences alleged are reasonable and justified, in light of the Postal Service's obligations and authorities.

E. The Filed Rate Doctrine Does Not Apply.

GameFly's Memorandum and certain of its pleadings contain discussions of the "Filed Rate Doctrine." GameFly Memorandum at 63-65.[34] GameFly describes the doctrine as "the prohibition against offering rates or service on terms that vary from the rates and classifications set forth in the lawfully published tariffs." *Id.* at 64. GameFly makes the unsupported claim that the doctrine was "codified" by the PRA in sections 3622-3625.[35] GameFly also argues that the doctrine represents a "broad public policy against secret preferences." June 23 Answer at 17. Under GameFly's theory, the "preferences offered to Netflix would be illegal even if the Postal Service could muster a rational justification for them." GameFly Memorandum at 65 (footnote omitted).

[34] June 23 Answer, at 16-17.
[35] GameFly cites no legislative history or judicial opinion to support this contention, and the Postal Service has been unable to find any.

This reference to preferences presumably means the Postal Service's operations practices involving the mail processing of Netflix DVD mail and the other alleged advantages enjoyed by Netflix as a result of the Postal Services conduct, or lack of conduct. GameFly maintains that these preferences amount to "material terms of service," and the doctrine "requires publication of classifications and material terms of service, not just rates." *Id.*

GameFly did not refer to the Filed Rate Doctrine in its Complaint. Its appearance in GameFly's Memorandum is likely the result of the evolution of the Complaint, discussed above, after the Commission implicitly acknowledged the correctness of the Postal Service's argument that section 3662 does not include section 404(b) as a jurisdictional basis for complaint.[36] GameFly was likely poised to argue that section 404(b)'s reference to "reasonable and equitable classes of mail and reasonable and equitable rates of postage and fees for postal services" provides the foundation for its argument that the "preferences" and other advantages enjoyed by Netflix were required to be incorporated as separate "terms of service" in the Postal Service's product descriptions and the Mail Classification Schedule (MCS). One might speculate that, when section 404(b) was removed from the picture, GameFly sent the Filed Rate Doctrine in as a last-minute substitution.

GameFly provides absolutely no support for its contention that the Filed Rate Doctrine requires a separate classification of "Netflix service" in the postal context (including notice, publication, etc.), other than its unsupported conclusions and references to judicial decisions pertaining to public utility

[36] *See* Order No. 235, at 5-7.

regulation in other industries. The Commission cases cited in paragraph 163 of GameFly's Memorandum, as well as the reference to the *UPS Worldwide* case, concern the publication of contract rates (ICMs and NSAs). None of those references support the proposition that the Postal Service has an affirmative obligation to establish separate classifications for every variant of mail processing that might be associated with postal products, or for any expectation that a mailer might have about the type and quality of service it should receive, as a result purchasing service under one of the Postal Service's product descriptions.

Furthermore, GameFly has offered no support for its contention that the "preferences" to which it refers are required by any statute, regulation, or judicial authority to be classified. In this regard, the foundation of GameFly's Complaint appears to rest on two assumptions: 1) that purchase of First-Class Mail letter or flat service entails an obligation by the Postal Service to provide a particular form of mail processing; and 2) that First-Class Mail service guarantees a specific level of freedom from risk of damage or loss in the mail. The first assumption is belied by every form of tariff or classification schedule that in modern times has controlled the offering of First-Class Mail. Congress long ago disposed of the second assumption by permanently exempting injury in the mail from claim under the Federal Tort Claims Act. Nor has freedom from damage or loss been incorporated in the legal instruments that govern the provision of First-Class Mail.

An examination of the regulatory framework governing postal products leads to these conclusions. Neither the Domestic Mail Manual (DMM), nor the

old Domestic Mail Classification Schedule (DMCS) incorporate the conditions that GameFly asserts into the descriptions and regulations governing First-Class Mail.[37] While the Commission has not yet proposed an MCS pursuant to its authority under the PAEA, the Postal Service's description of First-Class Mail service in its proposed classifications did not incorporate the conditions that GameFly describes.[38] In those proposals the Postal Service described the product as follows:

> **FIRST-CLASS MAIL**
> Any matter eligible for mailing may, at the option of the mailer, be mailed by First-Class Mail service. Matter containing personal information, partially or wholly handwritten or typewritten matter, or bills or statements of account must be mailed by First-Class Mail service, unless mailed by Express Mail service or Priority Mail service, exempt under title 39, United States Code or otherwise exempt by the Postal Service. First-Class Mail pieces are sealed against postal inspection and shall not be opened except as authorized by law. First-Class Mail pieces that are undeliverable-as-addressed are entitled to be returned to the sender or forwarded without additional charge. An annual mailing permit fee may be required.

Thus, First Class Mail does include certain service elements (sealed against inspection, free forwarding), but it does not guarantee a form of mail processing or freedom from risk. This description has been followed provisionally since the regulatory framework of the PAEA under Commission regulations took effect.[39]

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[37] *See* DMM §§ 230-236; DMCS §§ 210-280, reproduced in 39 C.F.R. 3001, Subpart C, Appendix A (2006).
[38] *See* United States Postal Service Submission of Initial Mail Classification Schedule in Response to Order No. 26, Docket No RM2007-1 (Sept. 24, 2007).
[39] *See* United States Postal Service FY 2009 Annual Compliance Report, Docket No. ACR2009, at 22-25 (Dec. 29, 2009); *Postal Regulatory Commission Annual Compliance Determination of U.S. Postal Service Performance, Fiscal Year 2009*, at 66-73 (March 29, 2010).

GameFly's reference to the current statutory and regulatory requirements governing products fails to support its sweeping claims regarding the Postal Service's obligations to specify operations and conditions in its product descriptions. GameFly Memorandum at 64. If anything, the PAEA and Commission regulations afford the Postal Service more discretion in establishing and maintaining its products than under the PRA, whose "codified" obligations under the Filed Rate Doctrine (according to GameFly) have now been superseded.

The Postal Service would not disagree that, broadly speaking, the "filed rate" doctrine shares some of the same purposes with certain provisions of title 39, such as section 403(c). None of the court cases to which GameFly cites, however, have invoked the doctrine in the context of the Postal Service. Moreover, GameFly cites no instance in which the Commission itself has claimed to be enforcing the "filed rate" doctrine. For example, as noted above, GameFly makes broad claims in paragraph 163 of its Memorandum. There GameFly cites four sources to support its assertions. The first (the *AT&T* case) does discuss the "filed rate" doctrine, but has nothing to do with the Postal Service, and the reference certainly provides no basis to claim that the doctrine addressed by the court in an entirely separate context applies to the Postal Service. The other three citations, on the other hand, all relate to the Postal Service, but do not even mention the "filed rate" doctrine.

Moreover, courts have recognized that:

> The filed rate doctrine does not have a life of its own. Its application depends on the underlying statute. To ask only whether

> the filed rate doctrine mandates [relief] is to miss an essential part of the inquiry. What says the statute?

Towns of Concord, Norwood, and Wellesley v FERC, 955 F2d 67, 73 (D.C. Cir 1992). Thus, Gamefly must focus on compliance with the provisions of title 39, not on principles with no demonstrated nexus to the Postal Service.

In this regard, the relevant question is, not whether the "filed rate doctrine requires publications of classifications and material terms of service" as an abstract proposition, but, rather, whether title 39 requires such actions in the context of the Postal Service's treatment of a particular type of mail (First-Class Mail) representing a broad array of types of mailpieces with multiple variations of physical characteristics. *See* USPS-T-1, at 27-28.

II. GAMEFLY HAS NOT ESTABLISHED UNLAWFUL DISCRIMINATION UNDER SECTION 403(C)

A. GameFly's Distinct Characteristics and Posture Do Not Support Its Discrimination Claims

Comparison of GameFly with Netflix reveals few similarities. GameFly purchases a different type of service; it has a different volume; it has different costs and business considerations; and it undertakes a different level of cooperation with the Postal Service. *See* USPS-T-1, at 7-11. Most glaring of these differences is GameFly's choice to pay for an entirely different service than Netflix. GameFly pays for flat service. *See* GameFly Response to USPS/GFL-48 (confirming that "GameFly [did not] mail any DVDs as First-Class Mail single ounce letters" and that "GameFly has always sent and received its DVD mailers as single-piece First-Class flats"). Netflix pays for letter service. GameFly

Memorandum at ¶ 19. By choosing a service different from the service received by Netflix and other disc mailers who purchase letter service, GameFly has chosen to receive a type of processing different from the type of processing received by Netflix. Accordingly, GameFly has no expectation of equality, and the different service it receives results from its own conscious choice. USPS-T-1, at 26-31.

GameFly attempts to get around this fundamental deficiency in its case by arguing that it would prefer to mail its discs as letters, but does not only because the Postal Service has not offered it manual processing. *See* GameFly Response to USPS/GFL-40 ("Without the elaborate manual processing and other special treatment that the Postal Service offers Netflix at one-ounce letter rates, the use of letter-rated DVD mailers is not a viable option for GameFly."). The record does not support this contention. GameFly has always purchased flats service to mail its discs. *See* GameFly Response to USPS/GFL-48 (confirming that "GameFly [did not] mail any DVDs as First-Class Mail single ounce letters" and that "GameFly has always sent and received its DVD mailers as single-piece First-Class flats"). It has never even attempted to mail its discs using letter service. *Id.* It has failed to identify any specific instance where it requested letter service with manual processing and was denied this request by the Postal Service. *See* Tr. 5/932-933 (conceding that GameFly witness "do[es] not have any evidence" of a meeting where a denial of manual processing occurred, and "can't identify anybody specifically who participated in the conversations" pertinent to the alleged denial of manual processing). In fact, on at least two

occasions the Postal Service expressed its willingness to provide service to GameFly on the same terms made available to Netflix, if GameFly were to use letter service to mail its discs. *See* May 17, 2010 Letter from Postal Service Counsel to GameFly Counsel ("May 17 Letter"); Postal Service Response to GFL/USPS-63 ("If GameFly were to begin entering its DVDs in lightweight mailers like those of Netflix, … [a]s with Netflix, the Postal Service would allow field officials to determine whether to manually cull GameFly's return mail, based on the discretion of field operations management to carry out what they consider the most efficient processes for GameFly return mail"). Indeed, the Postal Service indicated a willingness to go further on GameFly's behalf, particularly with respect to mail entry and delivery profiles that today cause GameFly's pieces to travel many times further, on average, than do those of Netflix. GameFly did not respond to the Postal Service's most recent letter offer. Tr. 5/944-946 (confirming that GameFly has not "made any contact with the Postal Service after receiving the May 17 Letter .. [t]o discuss the contents of the letter"). Through its intentional purchase of flats service, GameFly has chosen to receive service different from the service purchased by Netflix, and should have no expectation of similar service.

The flip side of this absence from a GameFly *prima facie* case exists in the total failure by GameFly to make any allegations directed at its comparative position with respect to other mailers of two ounce First-Class Mail flats. Hence, GameFly makes no credible showing of undue discrimination between processing of GameFly mail and that of any other mailer.

In addition to differences in the service purchased by GameFly and Netflix, GameFly and Netflix generate different volumes and densities of mail. Currently, GameFly has a volume of 7.2 million round trips per year. Tr. 11/1987. This accounts for less than one percent of all disc mail, and an even smaller percent of all total mail. *See* Direct Testimony of Larry J. Belair on Behalf of the United States Postal Service (August 6, 2010) ("Belair Testimony"), USPS-T-2, at 8. Currently, Netflix has a volume of 1.3 billion round trips per year. This accounts for up to ten percent of all mail in some plants; processing of Netflix mail therefore has a very substantial impact upon the overall efficiency of mail processing by the Postal Service, while GameFly volume is unable to impact overall efficiency at all, with the possible exceptions of plants closest to GameFly's own four processing plants, where its density increases. *See* USPS-T-2 at 8; Tr. 9/1717-1718.

For efficiency reasons, the Postal Service sometimes finds it beneficial to use different processing methods for high density mail. USPS-T-3 at 20. Postal Service witness Seanor explained, for example, that "[s]eparation of high density mail intended for a single recipient is a frequent and common method for increasing the overall efficiency of mail processing." *Id*. The Postal Service makes this strategy effective when processing high density mail with its processing of Netflix and, in some postal facilities, GameFly. *See* USPS-T-2 at 19-22 (describing manual separation of GameFly mail in South Florida). This strategy has proven effective in other contexts, for example, the processing of tax returns. USPS-T-3 at 21.

Even if, despite GameFly's low volume and sparse density, the Postal Service sought to apply nonstandard processing to GameFly mail pieces, it would be grossly counterproductive due to the inability to identify GameFly's mail.[40] Unlike Netflix, whose bright red mail piece color makes identification easy, GameFly uses a white mail piece. Appendix-USPS-GFL-1. Just as Netflix's high density and bright mail piece makes it more visible and easier to isolate for processing, GameFly's low density and plain color makes it less visible and more difficult to isolate for processing. *See* USPS-T-3 at 9-10, 18-19.

GameFly's legal claim presumes that the Postal Service is legally responsible for breakage. The founding principle of GameFly's arguments regarding responsibility for damage incurred by DVDs while being prepared for and mailed to customers, used by those customers, and then prepared for and mailed back to GameFly or Netflix also rests on a legal principle that does not exist: that the Postal Service is responsible for damage to mail incurred by mailpiece contents while in the mailstream. Federal law, in the form of the Federal Tort Claims Act (FTCA)—Chapter 171 of title 28, however, lies in the way of GameFly's complaint.

The FTCA generally immunizes federal employees from personal liability while providing a legal mechanism for compensating those injured by negligent or wrongful acts of federal employees committed within the scope of employment (*see* Section 2 of Publ. L. 100-694). However, the FTCA provides blanket immunity for "Any claim arising out of the loss, miscarriage, or negligent

[40] GameFly once used a highly visible, orange envelope. However, it ceased using a highly visible envelope when informed that high visibility also enabled theft (Tr. IV/668) of its expensive DVD games.

transmission of letters or postal matter." 28 U.S.C. 2680(b). So as a matter of law, the Postal Service is immunized completely from financial responsibility for damage to DVDs incurred in the mail. The potential for damage to DVDs, and supposed Postal Service responsibility for all such damage, lies at the very heart of GameFly's complaint. In reality, it constitutes a collateral attack against the FTCA limitations on liability that the Commission should accordingly deny; if not, then the D.C. Circuit Court of Appeals certainly will.

The responsibility for improving the likelihood that a mailpiece survives intact on a one way or round-trip through the mail—or repeated round trips—is shared broadly. The Postal Service develops processes and equipment that sort the mail, based on indicia or other markings and shape, thereby increasing efficiency and offering customers a wide range of mailing options; it also provides a wide range of guidance regarding mailpiece preparation so that all customers can prepare mail that meets all of their needs. *See, e.g.*,http://pe.USPS.gov (advice regarding mailpiece design and preparation, together with regulations affecting each mailer option). Mailers can choose the best combination of service and cost that meets their needs; a choice can impact delivery speed, transportation mode, type of handling, processing path, postage paid, and fees for extra services the sum of which best meets each mailer's goals and concerns. Insurance can help guard against breakage or loss. Express Mail can mean faster delivery and a more secure processing path, with some insurance built into the base price. Limitations on delivery are available to ensure delivery to a particular person or place, with documentation of when and to whom delivery

was effected and made available. Delivery customers also have a range of convenience and security options with delivery generally available to a business or home address, or to a postal facility for pick up.

Yet evidence in this case does illustrate that the Postal Service cares about damage incurred to mail contents. However, this concern is animated simply by an interest in providing customers with high quality service: any customer whose mail consistently arrives damaged would not thereby be incentivized to send mail again, let alone in greater quantities. The Postal Service recognizes that mailers do care what happens to their mail, and that all else equal—or *ceteris parabus*—customers prefer that mail not incur any damage while transiting the mailstream.

GameFly has evidently developed a mailpiece design that meets its needs. It provides some protection to enclosed DVDs, and by designing a two-ounce flat shaped piece it encourages use of the flats processing stream.[41] Indeed, GameFly is apparently wedded so completely to use of the flats mailstream that it has shown zero real interest in mailing, as Netflix does, single-ounce First-Class Mail letter shaped pieces. Presumably it could also develop a more robust package that eliminates essentially any likelihood of damage while in the mail. The testimony of witness Lundahl is, however, instructive and cautionary: because damage to DVDs is cumulative over time, and mere

[41] The Postal Service does not guarantee any specific processing path for any mail, with the possible exception of mail matter that travels in the accountable mailstream, wherein a trail of signatures denotes a handoff of personal responsibility for an item throughout its end to end trip through the mail from sender to recipient.

transportation in a truck induces some of that damage, no mailpiece design can likely ensure that every DVD is always playable when it reaches a customer.

Witness Lundahl identifies various potential ways that DVDs can be constructed that Netflix has found ways to use, but GameFly knew nothing about and has accordingly never used (Tr. VII/1308-09; Tr. V/892). These include limiting ultraviolet light exposure (when labels are printed), picking the best polycarbonates, avoiding moisture, cutter speed, cutter sharpness, specification for the cut, service life of the cutter, how hot the disc is when cut, mold temperature, amount of moisture in the polycarbonate mixture, thickness of the DVD (within tolerance), use of reinforcement rings, minimizing distance traveled through the mail, a new Blu-Ray coating, distance of ground transportation, use of label application machines, modified in-plant operations, and the impact of freezing temperatures; *see, e.g.,* Tr. VII/12971303; 1306-07; 1326; 1332; 1334; 1361-62; 1366-74; Tr. VIII/1537-40; 1545-46, 1550; 1554-55;

In this context, witness Lundahl's testimony becomes relevant to the claimed undue discrimination issue only when GameFly attempts to establish that GameFly, mailer of round trip two-ounce First-Class Mail flats containing at least one gaming DVD is sufficient similar (to sustain a claim of undue discrimination) to Netflix, mailer of round trip single-ounce First-Class Mail letter shaped pieces also containing at least one movie DVD.

At the most basic level, witness Lundahl's testimony establishes that Netflix has studied the physical and chemical properties of DVDs, and how they accumulate damage throughout their life cycles from production, handling,

preparation for mailing, within the First-Class Mail mailstream whether handled on automation or manually, or both, through use by customers, then remailed by customers back to Netflix. Such study has enabled Netflix to tailor the chemical constituents from which the DVDs it mails are manufactured, and to limit the processing steps (UV exposure to cure ink on labels) that increase a DVD's accumulation of damage that eventually leads to any DVD's failure. *Id.* Hence Netflix DVDs are less vulnerable to damage than are GameFly DVDs. GameFly is unable to observe this distinction, if only because it does not track the cumulative rental cycles its DVDs undergo. *See* Tr. VII/1308-09; 1312; 1364Tr. V/892.

In fact, the GameFly and Netflix damage rates are very similar, amounting to around one percent. Yet given the different respective processing paths their DVDs undergo, this fact is more coincidence than an appropriate basis for comparison. GameFly contends that its damage rate, if it were to use single-ounce First-Class Mail letters, would be unacceptably high. Given GameFly's complete failure to attend to the properties of DVDs, its damage rate might prove higher than it now experiences were it instead mailing letters, but there is absolutely no way to know what that result would be based on the evidentiary record. Yet since the breakage rate is its own legal responsibility anyway, it remains just as free now to choose how best to mail its DVDs as it has always been.

In general, mailers have their own costs, face different risks, and weigh business considerations when developing a business model that best suits each.

As this docket exemplifies, GameFly and Netflix have respective models that overlap only in superficial ways, such as the fact that both rent DVDs via the mail. Such distinctions in business models drive decisions, and cause mailers to react differently to the one constant factor: change over time. As a mailer of game discs, GameFly must deal with costs and risks different from the costs and risks of video disc mailers. Two significant differences are the higher cost of GameFly's product, game discs, and the higher theft risk that value plus ready conversion to cash bring.

REDACTED (Response to GFL/USPS-52), than the DVD movie discs shipped by other mailers. This causes GameFly to react differently to certain business conditions as compared to other video disc mailers. Video DVD movies, by contrast, cost approximately ten dollars apiece. At a one percent breakage rate, both GameFly's and Netflix' current breakage rate, GameFly would incur a $0.40 breakage cost per mailing, while Netflix would incur a $0.10 breakage cost per mailing. At a three percent breakage rate, the breakage rate for at least one DVD movie mailer disc through letter automation would cost less than GameFly's breakage cost. *See* GFL771, RDM Work Group Minutes (September 26, 2005) ("overall damage rate of 3%).

Because GameFly mails a higher cost product with a greater resale value, it faces a greater risk of theft. In fact, GameFly's theft cost is more than three times its breakage cost. *See* Complaint at ¶ 25. GameFly concedes that its business decisions reflect theft concerns. *See* GameFly Responses to

USPS/GFL-7, 12, and 15. DVD movie mailers, which have a lower cost product, face a lower theft risk and cost.

Finally, GameFly's dissimilarity to Netflix—its primary comparator for purposes of claimed undue discrimination—is aptly illustrated by its absolute failure to inform itself about the video disc (of any type) business and how to minimize breakage risk, despite its clear awareness that breakage is a risk. *See* GameFly Responses to USPS/GFL-29, 30, 31, and 32; Tr.5/889, 891-892, 936-937, 943. Through its responses to discovery and oral cross-examination, GameFly has demonstrated a lack of knowledge about its product, DVD game discs, and the disc mailing industry as a whole. *See* id. For example, GameFly conceded a lack of knowledge about the composition of its discs, the industry standards for its discs, and the costs and disc composition faced by other mailers. *Id.* GameFly's lack of knowledge contrasts sharply with Netflix's situation. As Postal Service witness Lundahl testified, Netflix has conducted extensive testing on the properties of discs and the causes of damage to discs. USPS-T-4; Tr. VII/1210-40; Tr. VIII/1390-1420. Netflix has used this research to develop effective methods of reducing the damage its discs experience during the mailing process, including changes in the disc composition and the addition of reinforcement rings to a disc's inner diameter. *Id.* Netflix's research has led to recommendations that have benefited all disc mailers, including changes to Blu-Ray disc surfaces and modifications to Postal Service processing equipment. *Id.* In addition to providing another example of the different situations of GameFly and Netflix, GameFly's lack of knowledge about its mail content, the mail content

of other disc mailers and the disc mailing industry as a whole undermine the validity of its claim that GameFly is similarly situated to Netflix.

While one might expect that GameFly, whose financial risk per disc mailed is several times larger than Netflix' risk, would be the more likely party to investigate disc breakage as Netflix has. Witness Lundahl's testimony establishes that Netflix has studied the physical and chemical properties of DVDs, and how they accumulate damage throughout their life cycles from production, handling, preparation for mailing, within the First-Class Mail mailstream whether handled on automation or manually, or both, through use by customers, then remailed by customers back to Netflix. Such study has enabled Netflix to tailor the chemical constituents from which the DVDs it mails are manufactured, and to limit the processing steps (UV exposure to cure ink on labels) that increase a DVD's accumulation of damage that eventually leads to any DVD's failure. Hence Netflix DVDs are less vulnerable to damage than are GameFly DVDs. GameFly is unable to observe this distinction, if only because it does not track the cumulative rental cycles its DVDs undergo.

Partly as a result of its lack of attention to the disc mailing industry, GameFly is not as proactive in dealing with the Postal Service as other postal customers. Many postal customers meet with local managers routinely in an effort to ensure that their mail receives the desired level of service, and to help the Postal Service resolve any issues associated with a particular customer's mail. USPS-T-3 at 12-13. Some customers provide the Postal Service with periodic reports informing the Postal Service about its service performance with

respect to timeliness, damage and other metrics. Tr. 10/1839-1840. Although GameFly meets with the Postal Service and communicates its concerns, it is not as proactive as Netflix and other mailers. *See* GameFly Response to USPS/GFL-38. A good example of this is GameFly's failure to respond to the May 17 Letter and discuss its concerns about the contents of the letter with the Postal Service. *See* Tr. 5/944-946 (confirming that GameFly has not "made any contact with the Postal Service after receiving the May 17 Letter .. [t]o discuss the contents of the letter").

Several additional factual distinctions further demonstrate why GameFly's legal claim is not supportable as a matter of fact. First, GameFly's mailpieces would have to be distinctive. *See* GFL/CX-8 (May 17, 2010 German letter to GameFly). **REDACTED** (Tr. 4/668)—a greater source of DVD loss for GameFly than breakage, as reflected in the chart showing the circumstances in which it changed its mailpiece over time.

Second, and perhaps most critical, is the GameFly response to the Postal Service offer to make the same conditions that control processing of Netflix mail also applicable to processing of GameFly mail. GameFly's response consists of the observation that such an offer does not actually guarantee that GameFly's pieces will be handled the same as most Netflix pieces. The Postal Service agrees. It does not guarantee any customer how its mail will be processed; consequently, Netflix also has no such guarantee. GameFly's response therefore confirms that the relief it claims to want actually exceeds what the Postal Service offers Netflix; it would also require the Postal Service to somehow

change the challenging mail processing environment that its witnesses describe in exquisite detail. Not surprisingly, GameFly's unreasonable, factually unsupportable, and illogical demands contain no explanation for how such profound changes could possibly be effectuated.

As described above, GameFly is not similarly situated to Netflix and it cannot satisfy the elements of discrimination under 39 U.S.C. 403(c).

B. GameFly presents a distorted and selective description of factual differences in treatment given to Netflix and GameFly.

GameFly has represented repeatedly that the Postal Service has not offered it service on the same terms as Netflix. *See* Tr. 5/888 ("[GameFly] ha[s] not been offered essentially what Netflix experiences"); GameFly Response to USPS/GFL-72 ("the Postal Service never offered to process GameFly's mail in the same manner as Netflix"); GameFly Memorandum, at ¶ 110 (referring to GameFly's request for a "concrete proposal for processing GameFly DVDs on terms and conditions offered to two large DVD mailers, Netflix and Blockbuster"). It contends, at least publicly, that it filed the complaint against the Postal Service for the purpose of obtaining service on the same terms as Netflix. Complaint at ¶ 57 (The requested relief "should include … an order prescribing the same prices and terms of service for GameFly, including the same degree of manual processing, that the Postal Service provides to Netflix and Blockbuster"); Objections of GameFly Inc. to USPS Discovery Requests USPS/GFL-5, 8, 12, 15-18, 25, 26, 28, 38, 39 and 46 (May 14, 2010) ("GameFly Objections") at 7 ("If the Postal Service refuses to offer GameFly the opportunity to bypass automated letter processing on the same terms offered to Netflix, the Postal Service is

discriminating against GameFly"); Tr. 6/1186 (recognizing that complaint requests "same rate structure and the same service, [the same] processes that Netflix gets"); Tr. 5/931-934. But, GameFly has never attempted to obtain service on the same terms as Netflix. GameFly Response to USPS/GFL-40 (providing negative response to interrogatory inquiring whether GameFly "consider[ed] preparing [its] mail pieces in the same manner that Netflix prepares its mail pieces"); Tr. 3/103. It admits that it has never mailed its discs as letters. GameFly Response to USPS/GFL-48 (confirming that "GameFly [did not] mail any DVDs as First-Class Mail single ounce letters" and that "GameFly has always sent and received its DVD mailers as single-piece First-Class flats"). And, despite its allegations that the Postal Service has denied GameFly service on the same terms as Netflix, GameFly cannot identify any specific instance where this denial occurred. *See* Tr. 5/932-933 (conceding that GameFly witness "do[es] not have any evidence" of a meeting where a denial of manual processing occurred, and "can't identify anybody specifically who participated in the conversations" pertinent to the alleged denial of manual processing). These odd circumstances amply illustrate how bereft of legal and factual foundation its complaint really is—this whole case constitutes an extended and unfortunate hypothetical exercise.

In fact, on at least two occasions, the Postal Service has expressed its willingness to provide service to GameFly on the same terms as service is provided to Netflix. *See* May 17, 2010 Letter from Postal Service Counsel to GameFly Counsel ("May 17 Letter"); Postal Service Response to GFL/USPS-63

("If GameFly were to begin entering its DVDs in lightweight mailers like those of Netflix, … [a]s with Netflix, the Postal Service would allow field officials to determine whether to manually cull GameFly's return mail, based on the discretion of field operations management to carry out what they consider the most efficient processes for GameFly return mail").

The letter Postal Service counsel sent to GameFly counsel laid out the terms of service provided to Netflix, and offered GameFly the same service as Netflix. *See* May 17 Letter; Tr. 5/897 (confirming GameFly's familiarity with the May 17 letter). GameFly does not dispute that this letter set forth an accurate description of the terms of service extended to Netflix. Tr.11/1962-1963 (confirming that Netflix meets the conditions contained in the May 17 Letter). Despite GameFly's assertion that it desires service on the same terms as Netflix, GameFly has not responded to the Postal Service's offer to provide GameFly service on the same terms as Netflix. Tr. 5/944-946 (confirming that GameFly has not "made any contact with the Postal Service after receiving the May 17 Letter .. [t]o discuss the contents of the letter").

Oral cross-examination of GameFly witnesses revealed that GameFly does not want service on the same terms as Netflix. *See* Tr. 11/1962-1967 (recognizing that the conditions of the May 17 Letter accurately describe the service provided to Netflix, but asserting that GameFly should not be required to meet two of the conditions contained in the May 17 letter). In fact, GameFly has admitted that it does not know the terms of service received by Netflix. *See* Tr. 6/1186 ("**REDACTED**"). In actuality, GameFly seeks service different from, and

superior to, the service provided to Netflix. *Id.* Netflix takes certain actions - including extensive transportation of its mail, induction of its mail at points intended to limit the distance its mail travels through the postal system, and pick up at approximately one hundred thirty locations – that reduce Postal Service costs and increase processing efficiency. *See* Tr. 11/1964-1965 (recognizing that transportation and pick-up points save "some cost"). GameFly seeks service without those terms. It wants the benefits of service received by Netflix without undertaking the efforts that make the service worthwhile to the Postal Service.

In addition, GameFly wants a commitment from the Postal Service that, if GameFly enters its disc mail at the one-ounce letter rate, the Postal Service will guarantee a particular level of manual processing. *See* Tr. 11/1961-1966. But any such commitment would exceed the service made available to Netflix. The Postal Service has made no commitment to Netflix regarding the level of manual processing it receives or the breakage rate experienced by its discs. *See* Tr. 10/1827, 1838-1839 (confirming that "the Postal Service [has not] committed to provide Netflix a certain level [of] processing"); Tr. 4/654-655. As stated repeatedly by the Postal Service, the service provided to Netflix relies on local discretion and varies across different plants. *See* USPS-T-3 at 9-12. Not only has GameFly requested a commitment to a particular type of processing – a request that exceeds anything offered to Netflix or any other mailer[42] - but it has demanded the issuance of a national standard operating procedure proclaiming this commitment. Tr. 11/1966. Netflix has received no commitment from the

[42] Generally, the Postal Service does not guarantee a specific type of processing for mail entered at a particular classification or rate.

Postal Service regarding a specific type or level of processing, and the Postal Service has issued no national directive or standard operating procedure governing processing of Netflix mail.[43] *See* Tr. 10/1827, 1838-1839 (confirming that "the Postal Service [has not] committed to provide Netflix a certain level [of] processing"). Despite GameFly's demand for a processing commitment, it cannot identify the specific level of manual processing that it seeks. *See* Tr. 5/945 (confirming that GameFly "didn't determine what specific level of commitment [for processing] would be necessary for it to accept the conditions in the [May 17 Letter]").

In summary, GameFly seeks service superior to that received by Netflix. It wants the benefits of the service received by Netflix without incurring the costs of the cooperative action that makes providing the service worthwhile for the Postal Service.

GameFly's previous demands and its lack of knowledge regarding the financial effects of mailing at letter rates and receiving certain breakage rates are consistent with its request for service on different terms than Netflix. In fact, the record suggests that GameFly really seeks lower rates for flats service, an entirely different remedy and a type of preferential treatment received by no other mailer. *See* USPS-T-1, at 2-4; Comments of Netflix on GameFly, Inc., Motion to Compel (August 30, 2010) ("Netflix Comments") at 2 ("this case is not about

[43] The one national directive that applies to Netflix mail concerns traying and sleeving. Trays stacked properly bear weight via the walls of trays rather than upon the mail contained by the trays. For mail susceptible to damage, which is true of mail enclosing DVDs even though that may not be obvious externally, this directive accordingly constitutes good business sense., See GFL-CX-1.

discriminatory treatment but instead an attempt by GameFly to manipulate the Postal Service, through the PRC, into offering it favorable mailing rates").

Before filing its complaint, GameFly demanded that the Postal Service allow it to continue to mail its discs as flats but charge it a lower rate. *See* Joint Statement of Undisputed and Disputed Facts (July 20, 2009) ("Joint Statement") at ¶ 121 ("GameFly requested that the Postal Service waive the additional ounce rate for GameFly pieces"); Tr. 5/922-925. GameFly conceded that it desires lower rates. *See* Tr. 5/904 (describing purposes of GameFly's September 10, 2008 meeting with the Postal Service as the exploration of "engineering and operational solutions that would enable [GameFly] to get better pricing … and … ways in which we could bring postage down and make it more economic to mail"). And, other observers of the case have recognized the likelihood that GameFly brought its complaint to extract lower rates from the Postal Service. *See* Netflix Comments at 2 ("this case is not about discriminatory treatment but instead an attempt by GameFly to manipulate the Postal Service, through the PRC, into offering it favorable mailing rates").

GameFly's apparent lack of knowledge about the financial effects of processing and breakage supports the understanding that the true purpose of its complaint is the pursuit of a lower rate for flats processing. GameFly has maintained repeatedly that it would prefer to mail at letter rates. *See* GameFly Response to USPS/GFL-40 ("As stated previously, GameFly would rather use letter mailers and pay one-ounce letter rates, as Netflix does, than continue to incur the added postage and other costs of two-ounce flats."). It claims that it

does not mail at letter rates because the Postal Service has not offered it manual processing at the same level as Netflix.[44] *See* id. ("Without the elaborate manual processing and other special treatment that the Postal Service offers Netflix at one-ounce letter rates, the use of letter-rated DVD mailers is not a viable option for GameFly.").

GameFly's actions, however, do not support its professed preference for letter rates. GameFly concedes that it has never attempted to mail its discs at letter rates. *See* GameFly Response to USPS/GFL-48 (confirming that "GameFly [did not] mail any DVDs as First-Class Mail single ounce letters" and that "GameFly has always sent and received its DVD mailers as single-piece First-Class flats"). When asked for an explanation why GameFly has not attempted to mail at letter rates, GameFly witness Hodess stated that it was a decision made before he became employed by GameFly. *See* Tr. 5/890. When pressed about his claim that the Postal Service had denied GameFly manual processing at the same level as Netflix, GameFly witness Hodess could not identify a particular instance when the alleged denial occurred or any individuals involved with any alleged denial. *See* Tr. 5/932-933 (conceding that GameFly witness "do[es] not have any evidence" of a meeting where a denial of manual processing occurred, and "can't identify anybody specifically who participated in the conversations" pertinent to the alleged denial of manual processing). Even GameFly's stated reason for mailing at flats rates - a professed desire for reduced breakage - is in dispute because GameFly admits that it has theft rates

[44] GameFly's institutional witness has explicitly disclaimed any assertion that the Postal Service has forced GameFly to mail at letter rates. *See* Tr. 5/894.

higher than damage rates, and a theft cost more than three times its breakage cost. *See* Complaint at ¶ 25; Tr. 6/1174 (confirming that "GameFly's theft rate [is] higher than its breakage rate"), 1176-1177. Automated processing is perceived to reduce theft risk. *See* USPS-T-2 at 19.

Despite GameFly's insistent requests for a "Netflix level of processing" and avoidance of an "unacceptable breakage rate," it appears that GameFly has put only minimal consideration into these requests it purports to seek from the complaint. For example, GameFly has not been able to define the "Netflix level of processing" it seeks with any more precision than the ambiguous term "high." *See* Tr. 5/897-900, 945 (confirming that GameFly "didn't determine what specific level of commitment [for processing] would be necessary for it to accept the conditions in the [May 17 Letter]"). With respect to its avowed desire for an avoidance of "unacceptably high breakage rates," not only is GameFly unable to provide an acceptable breakage rate, but it cannot even explain how it would assess whether a particular breakage rate is "unacceptably high." *See* Tr. 11/1968-1976; Tr. 5/890, 908. In light of this, any GameFly assertions regarding breakage rates have no credibility. GameFly's lack of knowledge and consideration regarding breakage rates prohibits any conclusion regarding whether measures other than avoidance of letter processing, for example, the measures described by Postal Service witness Lundahl, would result in breakage rates acceptable to GameFly. *See* Tr. 11/1968-1976.

As described above, GameFly does not seek service on the same terms as Netflix. GameFly's failure to respond to the Postal Service's offer of service

on the same terms as Netflix and its own description of the service it seeks conflict with the terms of service provided to Netflix. Even if the Presiding Officer accepts GameFly's alleged purpose for bringing the complaint, it must recognize that GameFly seeks not equality, but superior treatment through service better than that received by Netflix.

C. The Postal Service's treatment of GameFly and Netflix is reasonable and justified by efficiency and service concerns.

In general, local managers make decisions about how to process mail on a day-to-day basis. *See* USPS-T-2 at 20 (identifying "Postal Service operations approach of allowing local managers discretion to process mail using the most efficient method, according to particular local circumstances"); USPS-T-3 at 2-7 ("Local plant management is empowered to develop local operating procedures given their own unique operating conditions."); USPS-T-1 at 14-22 ("The Postal Service follows a sound policy of deferring to field discretion in making operations decisions."). They have significant discretion to make these decisions as they see fit. *See id.* However, a system of strict budget constraints and other supervisory processes holds these managers accountable for their decisions and ensures that mail is being processed efficiently. *See* Tr. 10/1812, 1834-1836 (referring to budget process, service standards, and clearance times as assurances of efficiency); Tr. 9/1710-1715 (same).

The Postal Service processes GameFly and Netflix mail efficiently. The processing of all disc mail reflects the discretion of local managers and consideration of a number of factors, including "available equipment, mail flow (volume, service commitment shape and weight), [] destination (which may

include delivery)", "density, how easily the mailpiece can be identified and captured (aided by visibility and easy access), and consideration of benefits versus costs (with time being a critical element of the latter)." USPS-T-3 at 2-3. The diversity of processing methods for Netflix mail, and disc mail generally, confirms the importance of these factors in processing decisions. The processing methods applied to Netflix mail range from one-touch manual separation to standard automation and depend on the specific conditions of each processing facility and the operational approaches of each postal manager. *See* id. at 9-12 (describing factors affecting processing decisions and range of processing received by Netflix).

As with Netflix, the processing of GameFly mail reflects the discretion of local postal managers. *See* USPS-T-2 at 19-22 (explaining that discretion-based processing applies to all disc mail processing, and describing GameFly processing in South Florida). However, because GameFly instructs the Postal Service to process its mail on automated flats sorters, the methods for processing GameFly mail are more consistent. *See* UPS-T-3 at 17 (referring to "GameFly's desire to have its mail run on postal automation"). GameFly prefers processing on flats sorters because its business model requires receipt of confirm scans to track its mail. *See id.*; GameFly Response to USPS/GFL-14 (identifying GameFly's use of CONFIRM service as GameFly's only "means of tracking individual DVD mailers"). In addition, GameFly believes that processing on flats sorters results in reduced disc breakage. *See* GameFly Response to

USPS/GFL-40 (explaining that breakage influences GameFly's decision not to mail its discs as letters).

Despite the Postal Service's adherence to GameFly's instructions and its accommodation of GameFly's preferences, the Postal Service's discretion-based processing results in some variance in the way GameFly mail is processed. For example, some facilities process all disc mail the same, including GameFly and Netflix, and some of these plants manually separate GameFly mail. *See* USPS-T-2 at 19-22 (explaining that discretion-based processing applies to all disc mail processing, and describing GameFly processing in South Florida).

Although local managers have significant discretion to make decisions regarding how to process mail, they must meet budgetary constraints and satisfy other compliance requirements intended to ensure that they make efficient processing decisions. *See* Tr. 10/1812, 1834-1836 (referring to budget process, service standards, and clearance times as assurances of efficiency); Tr. 9/1710-1715 (same). The accountability procedures that govern processing decisions include budgets, work hour limits, operating plans, service standards, and clearance times. *See id.* Failure to comply with these procedures has real consequences. *See id.* (describing consideration of performance under accountability measures during periodic reviews, and recognition of failure to meet performance standards).

The Postal Service has the most knowledge and information regarding the processing of all mail, including disc mail, GameFly mail, and Netflix mail. To share this knowledge and provide accurate information for the record in this

matter, it offered three witnesses.[45] These witnesses observe the processing of GameFly and Netflix mail daily as part of their job responsibilities, and they are well informed about the mail processing decisions made every day. *See* USPS-T-2 at 1; USPS-T-3 at 1. Combined, they have 70 years experience working for the Postal Service. *See* USPS-T-1 at iii (37 years); USPS-T-3 at ii (17 years); USPS-T-2 at ii (16 years). Their observations of mail processing goes back in time to the initial processing of GameFly and Netflix mail and extends to the current processing of GameFly and Netflix mail. *See* USPS-T-2 at 1 (comparing observation of 1 tray of Netflix mail per day in 2000 with more recent observation of 100 trays of Netflix mail per day). These knowledgeable and experienced witnesses have articulated a detailed and consistent description of how the Postal Service processes GameFly and Netflix mail, and the reasons for this processing.

In contrast, GameFly's witness[46] has never observed the processing of GameFly mail. *See* Tr. 3/93; Tr. 11/1983. The primary, and possibly sole, source of this witness' knowledge regarding how GameFly and Netflix mail is processed and the reasons for this processing is a study from 2006. *See* Tr. 11/1981 ("The primary source ['for [my] position throughout [my] testimony that Netflix' mail is processed in the way [I] describe'] is the Christensen study."); Tr. 12/2052 ("**REDACTED**"); GFL1020-1063 (dated November 2006). This study

[45]The Postal Service has a fourth witness, USPS-T-4 Rob Lundahl. Mr. Lundahl is an outside consultant whose testimony focused on disc breakage and related issues that are not central to this section of the brief.

[46] The Commission forced GameFly to provide a second witness, GameFly Chief Executive Officer David Hodess, to face oral cross-examination regarding GameFly's institutional responses to the Postal Service's discovery requests. However, Mr. Hodess gave no testimony in this case.

relied on a single observation of, at most, 17 processing facilities. *See* Tr. 12/2057. The Postal Service has approximately 400 facilities that process Netflix mail. Tr. 12/2046. The author of the study, Christensen Associates, chose these facilities at random, and did not consider the methods of mail processing used at these facilities. Tr. 12/2049-2050. And, after studying 17 facilities, the authors of the study concluded that none of the facilities used the same method to process Netflix mail. *Id.* Furthermore, the data underlying the study has not been updated since 2006. *See* Tr. 12/2057.

As described above, GameFly relies on outdated and limited information to form its position regarding the processing of GameFly and Netflix mail and the reasons for the Postal Service's methods of processing this mail. GameFly's informational deficiency has resulted from GameFly's conscious choice not to collect more current and extensive information regarding the processing of GameFly and Netflix mail, through a new study or, at the very least, use of a witness who has actually observed the processing of GameFly or Netflix mail. As expected from GameFly's reliance on stale, isolated information, GameFly's description of GameFly and Netflix mail processing and the reasoning for this processing is both inaccurate and inconsistent with the processing description provided by more knowledgeable Postal Service witnesses.

GameFly argues that the "main reasons" for Postal Service decisions regarding how to process Netflix mail are "the desire of Netflix for reduced disk breakage"[47] and "the Postal Service's own desire to avoid jams and other

[47] Oral cross-examination of GameFly witness Glick revealed uncertainty as to whether "the desire of Netflix for reduced breakage" is actually a "main" reason for Postal Service

processing problems." Rebuttal Testimony of Sander Glick on Behalf of GameFly, Inc., PRC Docket No. C2009-1 (October 21, 2010) ("Rebuttal") at 20. GameFly also contends that the Postal Service's decisions about the processing of Netflix mail are not justified by cost considerations. *See* Testimony of Sander Glick for GameFly, Inc., PRC Docket No. C2009-1 (April 12, 2010) ("Glick Testimony").. Both of these positions conflict with the testimony of Postal Service witnesses who make decisions about how to process Netflix mail every day. These witnesses informed the Commission and other parties to the case that they decide how to process Netflix mail based on efficiency and service considerations, and that their decisions are justified by cost considerations. USPS-T-2 at 3-6 (explaining how one-touch manual separation of Netflix mail improves efficiency); USPS-T-3 at 6-7 (same); Tr. 10/1877-1878 ("the activity of separating or culling … saves costs"); Tr. 10/1788 (confirming that "when manual handling of Netflix mailers occurs [it] is done because doing it manually is more efficient than running it through the automated letter processing equipment").

Repeatedly, Postal Service witnesses have identified efficiency and service as the main reasons for their decisions about how to process Netflix mail. *Id.* Yet, GameFly, relying on outdated and limited information, maintains that the main reasons for Postal Service decisions about how to process Netflix mail are "the desire of Netflix for reduced disk breakage" and "the Postal Service's own desire to avoid jams and other processing problems." Rebuttal at 20. As support

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decisions regarding the processing of Netflix. *See* Tr.11/1932-1941. For purposes of this brief, we will assume that GameFly takes the position that "the desire of Netflix for reduced breakage" is a main reason, but not as important as "the Postal Service's own desire to avoid jams and other processing problems." *See* Rebuttal at 20.

for this position, GameFly Rebuttal cites to 22 excerpts and 26 documents, and 8 paragraphs of the GameFly Memorandum that cite to over 50 additional documents. Rebuttal at 21-28. When pressed during oral cross-examination, GameFly witness Glick could identify only two passages that make reference to "the desire of Netflix for reduced breakage" as a reason for a particular processing. Tr. 11/1939-1945. Both of the passages identified by witness Glick appear on a national directive regarding the traying and stacking of Netflix pieces. *See* id. The processing steps described in this directive are completely distinct from the manual separation or "culling" and the resulting avoidance of automated letter processing that form the core of GameFly's complaint. The other documents cited in the Rebuttal make no reference to "the desire of Netflix for reduced breakage," and they do not even refer to Netflix or disc breakage. *See* id. ("not a specific reference to the DVDs being broken").

The Postal Service has explicitly denied that "the desire of Netflix for reduced breakage" is a main reason for its processing decisions. USPS-T-2 at 15-16; Tr. 10/1799-1801. Postal Service witnesses have explained that local managers who make processing decisions do not and cannot observe whether discs or other contents contained in mail pieces experience breakage during processing. *Id.* GameFly's inability to identify a single document that supports its claim that "the desire of Netflix for reduced breakage" is a main reason why the Postal Service manually separates or culls Netflix mail confirms the Postal Service's position that disc breakage is not a main reason for processing decisions.

The Postal Service recognizes that avoidance of jams and other processing problems, to the extent they impact processing efficiency, affect decisions regarding the processing of Netflix mail. Tr. 10/1798-1799; Tr. 9/1671-1672. But "the Postal Service's own desire to avoid jams and other processing problems" is not a "main reason" for decisions regarding the processing of Netflix mail. Tr. 10/1798-1799., 1877-1878. As part of a local manager's efficiency evaluation, avoidance of jams and other processing problems is one of many factors considered, including volume, available equipment, and the other factors described above. *See* id.; Tr. 9/1671-1672. A central efficiency reason for manually separating Netflix mail is the cost savings arising from limiting Netflix processing to one touch and avoiding additional steps necessary for automated and other methods of processing. USPS-T-2 at 3-6 (explaining how one-touch manual separation of Netflix mail improves efficiency); USPS-T-3 at 6-7 (same); Tr. 10/1877-1878 ("the activity of separating or culling … saves costs"); Tr. 10/1788 (confirming that "when manual handling of Netflix mailers occurs [it] is done because doing it manually is more efficient than running it through the automated letter processing equipment"). Even if Netflix mail ran on automation without any jams or processing problems, efficiency considerations would still support manual separation of Netflix mail and the resulting avoidance of multi-touch processing.

GameFly's contention that cost considerations do not support Postal Service processing decisions regarding Netflix mail reflects its reliance on outdated and inaccurate information. Postal Service witnesses who make

decisions about how to process Netflix mail every day have explained that, based on the actual costs and other conditions relevant to processing decisions for Netflix mail, the Postal Service processes Netflix mail efficiently. *Id.* These witnesses have explained in detail the budget requirements and other procedures intended to ensure efficient and cost-effective processing decisions. *See* Tr. 10/1812, 1834-1836 (referring to budget process, service standards, and clearance times as assurances of efficiency); Tr. 9/1710-1715 (same).

GameFly has derived its position regarding the cost of the Postal Service's processing of Netflix mail from the outdated and inaccurate information contained in a 2006 study. Tr. 11/1981 ("The primary source ['for [my] position throughout [my] testimony that Netflix' mail is processed in the way [I] describe'] is the Christensen study.") The author of this study compiled cost data based on limited observation, and, due to the lack of uniformity of processing methods, it created a different model for each processing facility. *See* Tr. 12/2057. None of the models provide an accurate measure of costs for the current methods used to process Netflix mail. For example, the lowest cost model used by the study is derived from a proxy for riffling. GFL1041-1042, Mail Characteristics Study of DVD-by-Mail. But, riffling requires a mail handler to touch and read the address of every piece of mail. In contrast, the manual separation processing of disc mail requires a carrier or mail handler to merely identify the color and shape of each piece of Netflix mail. Tr. 12/2070-2071. Because GameFly relies on cost data that measures a processing method different from the method the Postal Service

uses to process Netflix mail, any conclusions made by GameFly regarding the cost efficiency of Postal Service processing decisions are not credible.

For the reasons stated above, the Postal Service's processing of GameFly and Netflix mail is efficient and justified by cost considerations.

III. GameFly's Litigation Approach Has Created Flaws In The Record.

In litigating this case, GameFly has abandoned standard practice before the Commission. It brings a case that, for the most part, is unsupported by any testimony.[48] Instead, it relies on Postal Service documents that have not been sponsored, authenticated, or shown to be reliable by GameFly or any other party. In addition, GameFly has failed to follow the fundamental discovery rule requiring a litigation hold, making the conscious choice not to prevent the destruction of documents relevant to the case and responsive to discovery. GameFly's unorthodox and erratic approach to this litigation has caused the record to be inaccurate, incomplete and unreliable.

A. The record contains documents that are not accurate or reliable.

1. GameFly has not articulated the proper burden of proof.

It is a fundamental rule of evidence that the party seeking to rely on a document or other evidence has the burden of showing reliability and admissibility. *See Evans v. Port Authority of New York and New Jersey*, 192 F.

[48] GameFly filed two pieces of testimony from consultant Sander Glick. Mr. Glick concedes that his first piece of testimony does not address any elements of a discrimination claim. Tr. 3/116 ("I don't believe [my testimony] … address[es any of the elements of discrimination under 39 USC 403(c)"). The Postal Service has moved to strike witness Glick's second piece of testimony because it does not reflect any knowledge, observation, or expertise of the witness. Motion of the United States Postal Service to Strike the Rebuttal Testimony of Sander Glick for GameFly, Inc. (November 1, 2010).

Supp. 2d 247, 263 (S.D.N.Y. 2002) ("The burden of establishing admissibility, of course, is with the proponent of the evidence."). Not only does GameFly fail to recognize that it bears this burden, but it appears to argue that the burden should be flipped, and that the Postal Service must demonstrate that a document is not reliable. *See* Motion of GameFly, Inc. to Admit Certain Postal Service Documents into the Record, PRC Docket No. C2009-1 (October 29, 2010) ("GameFly Document Motion") at 10 FN 4 (suggesting that negative inference should be drawn from the Postal Service's failure to "sponsor[] one of the Christensen Associates professionals involved in the studies to challenge GameFly's interpretation of the studies" even though no party has sponsored the Christensen study as reliable). Requiring the Postal Service to provide testimony to disprove the reliability of documents makes no sense factually, and would not comport with the normal patterns by which due process rights are afforded to and utilized by each party.

GameFly blatantly ignores its own failures to meet the dual burdens of going forward and establishing the *prima facie* reliability of the documents it cites—thereby giving the Postal Service an opportunity to refute GameFly's position on a point by point basis. GameFly as complainant bears the burden of going forward to establish facts sufficient that it has made out a *prima facie* case; should it manage its burden—which the Postal Service does not believe GameFly has - then the burden shifts back to the Postal Service to prove why that case is incorrect or not persuasive, as a matter of fact and law. As things now stand, the proper inference for the Commission is that no party has

established the reliability of the documents cited by GameFly, including the Christensen study. GameFly has failed to establish facts necessary to shift the burden of going forward in rebuttal to the Postal Service. GameFly is accordingly inviting the Commission to engage in an extreme violation of this normal give and take by which the burden of going forward shifts between the parties, with the Commission making its decision on the net result. GameFly's position amounts to an attempted elusion of its own burdens of establishing a *prima facie* case. It cannot shift those burdens to the Postal Service. The Presiding Officer should accordingly hold GameFly accountable and require it to satisfy the burden of showing the reliability of evidence it seeks to offer in accordance with the laws of evidence.

2. GameFly has ignored Commission rules regarding reliance on studies.

GameFly's superficial arguments in this regard studiously avoid comment on prior Commission practice. As the Commission is well aware, however, the issue of what status should be accorded studies, analyses, and other documents offered by parties to support their positions in Commission proceedings has a long history. Much of the evolution of the Commission's practice has surrounded debate over the status of library references in rate and classification cases under the procedures governed by the Postal Reorganization Act (PRA). A considerable amount of precedent also arose out of questions relating to the status of cost and other studies and computer analyses and models. Admittedly, the Postal Service has been on the losing end of many of the controversies in the past. The Commission, however, has attempted to hold the Postal Service to a

high standard in order to ensure the effectiveness of its procedures to produce reliable evidence and afford all parties due process rights under applicable principles of administrative law. The Commission should apply no less a standard to parties like GameFly, who seeks to establish and enforce against the Postal Service a serious legal complaint having potentially far-reaching consequences.

When dealing with the use made of materials in Commission proceedings, and the degree of reliance by the party asserting their authenticity, the Commission has followed an approach that evaluates status on a case-by-case basis. *See* Presiding Officer's Ruling No. R90-1/65, Docket No. R90-1, at 5 (Sept. 6, 1990). Particularly with regard to documents claimed to be imbued with "official status" by virtue of their origin as public records, the Commission has taken a highly nuanced approach to evaluating evidentiary status. In PRC Docket No. R90-1, in assessing the status of a variety of kinds of documentation, the Presiding Officer stated:

> In general, the analysis agrees that the documents associated with the Postal Service, the Commission, and the GAO are public documents within the meaning of rule 31(d), but finds this does not resolve their evidentiary status, nor automatically preclude any further inquiry into authentication and sponsorship. Admissibility is determined on a case-by-case basis, depending on the nature of the material and use to which it is put by the witness.

Id. at 5.

In this case, GameFly's direct case, as well as its testimony filed on rebuttal, is almost completely derived from its reliance on Postal Service documents, or, in large part more precisely, documents found in Postal

Service files that may or may not reflect reliable study findings, analyses, and official opinion. To a very large degree, furthermore, GameFly offers its arguments and testimony, not as the opinion of its own experts, but rather as summaries of unsponsored conclusions and interpretations.[49] In this context, the Commission should apply its higher standard of proof, realizing that the reliability of the evidentiary record depends on the discipline that legal principles of evidence and procedure impose on the administrative process, and that GameFly, not the Postal Service, has the burden of proving its case. *See* Order on Certified Motions, Order No. 1201, Docket No. R97-1, at 14 (Nov. 4, 1997)([In rate cases], "the proponent of any particular finding must attempt to provide sufficient evidence so that a Commission finding in favor of that proposition can be said to rest on 'substantial evidence.'")

GameFly's case relies heavily on the Christensen study and other studies. Its witness testimony, the only evidence proffered by GameFly, relies almost exclusively on the Christensen study. *See* Tr. 11/1981 ("The primary source ['for [my] position throughout [my] testimony that Netflix' mail is processed in the way [I] describe'] is the Christensen study.") Despite relying so heavily on studies, GameFly has ignored Commission procedures and has not proven sponsorship of any of these studies.

[49] To the degree to which GameFly's approach in this case reflects a conscious attempt to insulate itself from scrutiny through a particular litigation strategy, in past proceedings, Presiding Officers and the Commission have not favored such strategies. *See* Presiding Officer's Ruling No. R97-1/20, Docket No R97-1, at 10 (September 17, 1997); Order on Certified Motions, Order No. 1201, Docket No. R97-1, at 16 (Nov. 4, 1997).

Rule 31(k) of the Commission's rules sets forth the requirements that a party must satisfy to submit a study into evidence or rely upon it. This rule states, at a minimum, that

> [i]n the case of all studies and analyses offered in evidence in hearing proceedings or relied upon as support for other evidence, there shall be a clear statement of the study plan, all relevant assumptions and a description of the techniques of data collection, estimation and/or testing. In addition, there shall be a clear statement of the facts and judgments upon which conclusions are based, together with an indication of the alternative courses of action considered.

39 C.F.R. § 3001.31(k). Further documentation requirements are specified in that rule for statistical and computer studies.

Over twenty years ago, in Docket No. R87-1, the Commission faced an issue involving what expectations should arise from reliance on a study that had been produced by a consultant to the Postal Service but not relied upon or sponsored by the Postal Service in an omnibus rate case. Parties other than the Postal Service sought to rely on the study for their own purposes. After considering the Postal Service's objections, the Commission directed the Postal Service to provide a witness to sponsor the study, rather than rely on it in its unsponsored form. In this regard, the Postal Service believed at the time that the Commission had struck the wrong balance in ordering the Postal Service to sponsor the study. In retrospect, however, the Postal Service must admit that the evidentiary and procedural principles the Commission enunciated had considerable weight. The Commission stated:

> The Postal Service seems to recognize this duty when it argues that the factual material in the study is freely available to the parties for their expert witnesses to rely on in formulating their own conclusions. But this argument overlooks the rules of evidence that

> forbid acceptance of evidence into the record unless there has been an opportunity to test it through cross-examination, and that an opportunity to cross-examine evidence is generally not adequate unless a witness is made available who is competent to attest to its authenticity and veracity. That is why interrogatory answers must be attested to under Rule 25(b), why oral testimony must be under oath, and why documents submitted for the record must be authenticated, under Rule 31. Rule 31 specifically states that designation of a document as a library reference does not confer any evidentiary status upon the document.

Order Directing Production of Postal Service Witness, Order No. 772, Docket No. R87-1, at 3-4 (August 14, 1987). In so ruling, the Commission followed a clear principle that subordinated expediency and formality of status, in favor of an evidentiary standard calculated to ensure reliability and due process. *See also,* Presiding Officer's Ruling No. R2000-1/92, Docket No. R2000-1(July 18, 2000)(directing the Postal Service to provide a witness to sponsor a study referred to in a Postal Service witness's interrogatory responses); Presiding Officer's Ruling Granting Motion of United Parcel Service for Authorization to Depose Certain Postal Service Employees, Docket No. MC78-1 (Dec. 15, 1978)(directing the deposition of Postal Service witnesses whose opinions were cited in Postal Service testimony).

This Commission's rules apply to the Christensen Study and the costing and other analyses incorporated in the OIG Report, because they rely upon a "study" under rule 31(k). *See* 39 C.F.R. § 3001.31. No party has undertaken the rule 31(k) procedures for entering the Christensen Study or the OIG Report into evidence. In fact, GameFly has disavowed sponsorship of the OIG Report. *See* Tr. 11/1952-1955 (conceding that witness Glick "[i]s not sponsoring" the OIG

Report). If GameFly intends to rely on these documents for evidentiary support, it must sponsor them and provide the foundation required by the Commission's rules. *See* Presiding Officer's Ruling No. R2006-1/74, Docket No. R2006-1, at 6 (October 2, 2006)("Professor Kelejian's declaration, although incorporated within witness Clifton's testimony, cannot properly be admitted into evidence without Professor Kelejian's sponsorship and submission to discovery under section 30(e) of the rules of practice.").

GameFly does not recognize the Commission's Rule 31(k) procedures or explain why they should not apply to the Christensen Study or OIG Report. Instead of addressing the Commission's rules, GameFly makes unsupported representations regarding the reputations of the OIG and Christensen Associates. *See* GameFly Document Motion at 5 ("The OIG is a highly respected investigative arm of the Postal Service."); *id*. at 9 ("Christensen Associates is a reputable economic consulting firm."). Self-serving representations that the author of a study or report is "highly respected" or "reputable," even if true, do not demonstrate the accuracy or reliability of the study or report produced by the authors. *Cf*. Arthur Andersen and Enron. In addition, despite GameFly's unsupported contentions, a party who commissions a report expresses no position regarding the report's reliability or accuracy, as at the time of the commission it has no knowledge of the results. If that or some other party subsequently wants to rely upon the study's results, then it faces Rule 31(k), at least if the proceeding is before the Commission.

Because GameFly has failed to comply with the Commission's rules, it has not demonstrated the reliability of the studies upon which it relies. In fact, Postal Service witnesses have expressed repeatedly the Postal Service's disagreement with the accuracy and reliability of these reports. *See* Tr. 9/1715-1717 (Christensen); Tr. 10/1888-1889 (OIG).

3. GameFly has not demonstrated the reliability of the Christensen Study and other documents upon which it relies.

With respect to the Christensen study, the Postal Service does not believe that the study provides any realistic understanding of how DVD mail is processed; while no other attempts to estimate costs of processing DVD mail are known to exist, the Postal Service position has been shared systematically since its refusal to acknowledge the propriety of remedial measures suggested by the OIG report—which also relies heavily on the flawed Christensen report. The Postal Service has shown, using the budget- and performance-driven financial and operational logic of mail processing decisions, exactly how and why the Christensen study is unreliable. *See* Tr. 9/1710-1715; USPS-T-3 at 2-7.
In evaluating the instant complaint, the Postal Service does not believe that the Christensen study provides reliable or appropriate estimates of how DVD mail is actually handled, let alone its appropriate costs.

GameFly witness Glick's testimony and responses to oral cross-examination demonstrate the inaccuracy of GameFly's conclusions derived from the Christensen study, as well as witness Glick's lack of knowledge sufficient to make reliable statements about the Christensen study. Despite his near absolute

certainty about the soundness of the Christensen study, witness Glick could not defend its modeling of Postal Service processing costs. Witness Glick admitted that Christensen Associates selected the seventeen processing facilities that it modeled randomly, and that the random selection did not account for the different methods of processing used by the approximately four hundred facilities that process Netflix mail. Tr. 12/2049-2050. He also cited the wide variety of standard operating procedures applicable to Netflix mail as support for his position that a study of Postal Service processing of Netflix mail that accounted for diverse processing practices was not feasible for Christensen Associates. *See* Tr. 12/2082-2085. He did not express an opinion as to whether this type of study would be feasible for another firm, or whether it would be helpful in determining the cost of processing Netflix mail.

Contrary to witness Glick's testimony, the Christensen Study's failure to incorporate processing methods other than processing methods used at the seventeen facilities studied by Christensen reflects a fatal flaw in the study and makes it unreliable. Witness Glick's responses to oral cross-examination draw out this flaw. Witness Glick confirmed that Christensen Associates studied seventeen facilities and developed seventeen different models. Tr. 12/2046, 2050. A projection of this finding to all postal facilities that process Netflix mail would result in over four hundred different models and over four hundred different processing methods. Witness Glick attempts to justify this point by contending that the seventeen different processing methods were quite similar. However, he admitted that the Christensen study did not measure the primary method of

processing Netflix mail as identified by Postal Service witnesses, the one-touch method of separating Netflix mail at the first touch, placing it in a tub or tray, and handing it off to Netflix. Tr. 12/2080. And, he conceded a lack of knowledge about whether the Postal Service used, for any purpose, the riffling proxy model, the proxy model used by Christensen with the lowest cost, though still higher than the cost of the one-touch method identified by the Postal Service. Tr.12/2088-2089. Finally, witness Glick refers repeatedly to a "National SOP" regarding traying and sleeving, and though he incorporates this process into his cost calculation, he offers no evidence that the standard operating procedure was followed in practice.

Witness Glick's testimony and responses to oral cross-examination also reveal his lack of fundamental knowledge regarding the processing of Netflix mail. This lack of knowledge is not surprising considering that witness Glick has never observed the processing of Netflix or GameFly mail, and relied almost exclusively on descriptions of processing as observed in 2006. *See* Tr. 3/93; Tr. 11/1983; Tr. 11/1981 ("The primary source ['for [my] position throughout [my] testimony that Netflix' mail is processed in the way [I] describe'] is the Christensen study.") Witness Glick admits that his use of the term "manual processing" has different meanings throughout his testimony. Tr. 11/1778-1791. Despite multiple opportunities, he could not clarify his definition of "manual processing" or his understanding of how Netflix processing during oral cross-examination. *See* id.

REDACTED

a. The Christensen Study has long been recognized as unreliable, a weakness that is not cured by GameFly's reliance upon it.

REDACTED

b. Each mailer is responsible for the shape and sanctity of the mail it enters into the mail.

Since the mid to late 1990s, mailers have relied on the Postal Service to distribute rental DVDs through the mail. Individual DVD mailers made the decision to rely on a mail distribution business model based on the Postal Service processing/delivery structure and price structure that existed at the time each mailer entered the market.[50] Furthermore, the decision as to whether their mail pieces were entered as cards, letters, flats, or parcels were decisions ultimately made by the mailers; these decisions were not made by the Postal Service. Such behavior comports with the legal reality that the Postal Service is not responsible for damage incurred in, or loss of, matter damaged in the mail. 28 U.S.C. § 2680(b). Instead, all participants consider potential damage to mailed matter, yet each deals with it in accordance with the risk calculus inherent in its business model by choosing an appropriate mailpiece design, shape and postage price, and any available special services such as particular handling, insurance or required signatures.

In its complaint, GameFly contends that it suffers from an unlawful discrimination among DVD mailers (Count I), an unlawful discrimination among flats mailers (Count II), and a lack of reasonable and equitable rates for First-Class one-ounce flats (Counts III and IV). As relief to these claims, GameFly

[50] Some of these decisions are likely short term in nature given that some volume will inevitably leave the mail system due to technological improvements related to DVD download capabilities.

requests the same prices and terms of service afforded Netflix and Blockbuster, including the same degree of manual processing.

Shape-related Issues: A disturbing aspect of this case is the suggestion that a given mailer that willingly enters its mail using one postal shape can claim it is being discriminated against based on the prices and processing methods associated with another shape of mail. This is doubly true given the absence of any particular processing method, especially automated processing method, associated with any particular postage rate or shape. The GameFly mail pieces are being assessed the prices they are currently assessed and are processed the way they are currently processed largely because of decisions made by GameFly.

The chief executive officer (CEO) of GameFly, witness Hodess, acknowledged that GameFly would rather generate letter mail pieces, but, instead, mails DVDs to its customers using flat-shaped mail pieces due to their concerns about DVD breakage.[51] The basis of the damage concerns is unclear given that witness Hodess also acknowledged that GameFly has never conducted a rigorous study of the types of disc damage and their causes,[52] has not determined what an acceptable damage rate would be,[53] and has some DVDs that have been in circulation since the company began operations seven years ago.[54] While GameFly is convinced postal processing methods are the primary cause of damage, witness Hodess acknowledges that they do not know

[51] Tr. 5/735.
[52] Tr. 5/713.
[53] Tr. 5/712.
[54] Tr. 5/724.

the percentage of mail pieces damaged by GameFly or its customers.[55] Furthermore, witness Hodess acknowledges that the damage rate of the flat-shaped GameFly mail pieces appears to be virtually identical to the damage rate of the letter-shaped Netflix mail pieces, despite the fact that the processing methods differ.[56]

No evidence in this case that supports the conclusion that the GameFly breakage rate would decrease if the Postal Service attempted to process GameFly flat-shaped mail using the same methods relied upon to process Netflix letter-shaped mail. It is not surprising that there is no support for such a conclusion given that witness Hodess admits GameFly has not attempted to mail their DVDs as First-Class Mail one-ounce letters.[57] In fact, the very reason witness Hodess provides as to why GameFly does not pay letter rates is that GameFly does not want its mail pieces processed on letter sorting equipment.[58]

There is no question that the GameFly mail pieces are indeed flats. The height dimension of the GameFly mail piece, which is 7 ¼",[59] appears to be the dimension that fails to meet the standard-size letter requirement. Section 201.3.3 of the Domestic Mail Manual (DMM) specifies that the maximum height for a standard-size letter is 6 1/8". GameFly has, moreover, made informal representations that its mailpieces are sufficiently thick that they are culled at the AFCS.

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[55] Tr. 5/784.
[56] Tr. 5/856.
[57] Tr. 5/857.
[58] Tr. 5/885 at 18-21.
[59] Tr. 5/870-871.

GameFly claims in Counts II and III of its complaint that there is undue discrimination among flats mailers because one-ounce flats are intentionally processed on letter sorting equipment unless mailers pay an additional ounce rate (although this claim appears to have been abandoned in later pleadings). In order for such a claim to be true, postal employees would have to intentionally isolate this mail after it is entered at a business mail entry unit (BMEU), move it to letter sorting equipment for subsequent processing, and ensure that it is, in fact, processed on letter processing equipment. Given that BMEU employees and mail processing employees work in different functions in different parts of a given plant at different times of the day, such a conspiracy is difficult to envision. The fact that a given plant processes hundreds of thousands of mail pieces on a given day, of which GameFly mail pieces represent a very small percentage, makes it even less plausible. A much more likely scenario is that mail processing employees finding GameFly mail anywhere on the work room floor would see the "FIRST-CLASS MAIL FLAT" and "PROCESS ON AFSM100" endorsements prominently featured on the GameFly mail pieces, as shown in Attachment A of the Complaint, and would forward that mail to the appropriate operation.

Count IV of the complaint would seem to imply that all mail pieces of a given shape should be processed on the equipment that generally corresponds to that shape. The Postal service does not, however, guarantee that any particular processing method will be used for mail entered at any specific price or with any specific mailpiece characteristic. It is widely acknowledged that a small percentage of mail for any given shape ends up being processed on equipment

related to another shape of mail. In fact, the Commission instituted an expanded presort letters and presort flats cost pool classification scheme in Docket No. R2006-1 largely based on intervenor testimony, such as the testimony of witness Buc. One of the many justifications witness Buc attempted to use to support his revised cost pool classification scheme was the fact that some letters are processed in flats operations.[60] There is no way a policy could be implemented in which the Postal Service could ensure that mail pieces assessed rates for a given shape of mail would only be processed on the sorting equipment related to that shape of mail because the lines between mail pieces shapes are sometimes blurred, and it is not always possible for mail processing employees to determine the actual rated shape of a given mail piece based on examination of it or its endorsements.

DVD Mailer Issues: A second disturbing aspect of this case is the suggestion that mailers should be allowed to dictate how their specific mail is processed. In Count I of the Complaint, GameFly implies as much when it demands that its mail be processed manually. As described above, the GameFly return mail pieces are indeed flats, and they are entered as flats because of decisions made by GameFly. Despite these facts, GameFly wants their low volume, flat-shaped mail pieces to be culled and processed manually in a fashion similar to the manner in which they claim the high-volume, letter-shaped Netflix mail pieces are culled and manually processed.

According to witness Belair, “Volume and visibility are likely the most important factors enabling separation of like pieces for direct dispatch. When a

[60] Docket No. R2006-1, PB-T-2, page 21 at 11-12.

mailpiece is easily identifiable in significant volume, removing mailpieces from the collection mail stream and subsequent cancellation operations reduces downstream handling that otherwise would require multiple processing (automation and non-automation) steps."[61] Witness Seanor concurs.[62] In this case, both the volume and visibility factors work against GameFly.

As witness Belair indicated, Gamefly return DVD mail pieces represent less than one percent of the total DVD return mail pieces.[63] In paragraph 13 of the Complaint, GameFly indicated that it mails 590,000 DVDs to its subscribers each month. Assuming these DVDs are all entered into the single-piece mail stream as return business reply mail (BRM) mail pieces, the average hourly volume processed through one of the roughly 250 mail processing plants with outgoing operations on an hourly basis and average day during the four-hour advanced facer canceller system (AFCS) processing window specified by witness Seanor,[64] would be quite small. Furthermore, the four-year-old sponsorless Christensen model, upon which witness Glick relies,[65] indicates that this mail could be culled in just about any letters or flats operation at a given plant.[66] Even if the Postal Service attempted to cull GameFly return flat-shaped mail pieces, the efforts required to have all the employees staffed at these operations throughout the plants looking for this mail would likely be futile and amount to their looking for a needle in a haystack, if that.

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[61] USPS-T-2, page 12 at 16-21.
[62] USPS-T-3, page 6 at 12-19 and page 9 at 11-16.
[63] USPS-T-2, page 8 at 8.
[64] USPS-T-2, page 4 at 19-20.
[65] GFL-T-1, page 5 at 8 to page 5 at 2.
[66] Please see the "Points Culled" section in any of the Christensen Associates cost models.

As witness Seanor stated, “Separation of high density mail intended for a single recipient is a common method for increasing the overall efficiency of mail processing.”[67] It is widely known that mail for large volume mailers is often held out in “upstream” operations for efficiency reasons. Consider the following sentence as an example:

> The mail for a high volume local utility company is held out in the automation outgoing primary operation at Plant X in order to avoid multiple handlings in subsequent operations.

Now rephrase this sentence:

> The mail for a high volume DVD mailer is held out in the manual culling operation at Plant X in order to avoid multiple handlings in subsequent operations.

The only difference between these two scenarios is the operation in which the mail is held out. Witness Belair also pointed out that there are high volume seasonal mailings related to voting (ballots), tax returns, and census documents in which it is absolutely imperative that the mail be held out as early as possible.[68] Using the GameFly logic, no mailers should ever have a bin on any machine dedicated to the isolation of their mail. Otherwise, the rest of the mailers are suffering from unlawful discrimination. It is highly likely that at least some of the plants located in the four cities in which GameFly maintains distribution centers do have dedicated AFSM 100 bins for GameFly mail. If that proved to be the case, are the non-GameFly flats mailers therefore suffering from unlawful discrimination?

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[67] USPS-T-3, page 30 at 21-23.
[68] USPS-T-2, page 7 at 16-22.

In fact, there is at least one instance where a price category was established for high volume mailers. The high volume qualified BRM price category was established in Docket No. R2000-1 to reflect the fact that the billing costs for high volume mailers are largely fixed. Does the existence of the high volume QBRM price category today therefore constitute unlawful discrimination?

When the Postal Service isolates high volume mail to avoid subsequent handlings everyone wins because the average mail processing unit costs, upon which the prices are based, are lower than they otherwise would have been. In order to minimize costs and maximize efficiency, the Postal Service needs to have the flexibility to process the mail as it sees fit. A mailer should not be able to dictate that its mail be culled manually to avoid processing equipment. If that were the case, it's likely that every mailer would want their mail culled manually the moment it enters the plant workroom floor.

The GameFly argument concerning manual culling and processing tasks centers around witness Glick's cost estimates and his reliance on the four-year-old sponsorless Christensen model. It should be noted that neither witness Glick nor any Christensen Associates employees have ever sponsored the letters mail processing cost models, like those normally presented in document 10 of the annual compliance reports, on the record in Commission hearings.

The fact that there might be cost differences between various single-piece mail types is not especially enlightening or entirely relevant. There has always been a great deal of cost averaging within the First-Class single-piece mail stream. In fact, the only instance of single-piece de-averaging was the QBRM

barcode discount proposed by the Postal Service, and subsequently approved by the Commission, in Docket No. R97-1.

The purpose specified in the CA Study that accompanied the Christensen models in no way indicates that this analysis was going to be used to support any such Postal Service proposal of any kind. The study does not indicate what group or function initiated the study. The report does not indicate whether the various postal functions, namely Operations and Finance, endorsed its findings. In fact, it's impossible in looking at the report to determine whether the study was even finished.

At this point in time, there are several problems with this report and the CA Study. First and foremost is the fact that no witness has sponsored this study and vouched for the authenticity and/or accuracy of the results. This is unprecedented in Commission hearings.

Second, this study is now over four years old. The Postal Service has not been operating in a vacuum. Operations have changed as the Postal Service has adapted to volume declines. One example is the drastic reduction in the AFCS processing window described by witness Seanor, as cited above. While letter mail processing equipment has not changed significantly over the past ten years, the Postal Service is currently in the process of deploying the new AFCS 200, as both witness Belair[69] and witness Seanor[70] described in their testimonies. This is one of the first major letter mail processing changes that the Postal Service has instituted in several years. The specific impact that it might have on future DVD

[69] USPS-T-2, page 17 at 11-12.
[70] USPS-T-3, page 11 at 23-24.

mail piece processing is unknown. It is possible that the AFCS 200 will impact how DVD mail pieces are processed in the future, regardless of how any given plant may be processing that mail now. The AFCS 200 is also part of the culling and cancellation operation, which is central to this case given that GameFly wants to receive manual culling and processing in order to avoid letter mail processing equipment.

Third, there are issues with the model itself. In fact, witness Glick himself had an issue with the model.[71]

The manual culling task is central to any cost analysis and, as the CA Study indicates, proxies were used. No attempt was made to estimate a new productivity based on what was actually observed in the field. Given that this task was central to the case, one would anticipate that new productivity values might have been measured. Witness Glick made no attempt to measure a new productivity value and, unfortunately, no one can be asked questions about these proxies because no witness has sponsored the CA Study.

In addition, one need to only look at the Scenario 1 Orlando cost model to see that this model was not likely finished. The Orlando model indicates that 10,000 mail pieces are culled manually before reaching the AFCS. The Orlando model then indicates that those 10,000 pieces are processed in a facing and preparation operation. At this point, even though these mail pieces would have already been isolated, faced, and placed into trays so that they could have been directly handed over to Netflix, the Orlando model indicates that the 10,000 mail pieces are next processed through an automation incoming SCF operation. The

[71] GFL-T-1 page 5 at 17 to page 6 at 5.

Orlando model next indicates that the 10,000 pieces (less the rejects from the previous operation), were processed through an automation incoming secondary delivery point sequencing (DPS) operation that is typically relied upon to sort the mail into the order a carrier walks his or her route. Finally, the Orlando model indicates that all 10,000 pieces are then riffled for accuracy after receiving both manual and automation processing. Such a processing scenario defies belief.

The Postal Service maintains its objection to this model being placed on the record. Even if the model is ultimately incorporated into the record, there are certainly enough issues related to its authenticity, accuracy, and currency that would prevent it from being used as a basis for providing GameFly any relief in this case.

As part of that relief, even if the Postal Service were directed to manually cull GameFly mail pieces in compliance with GameFly demands, postal employees still may be unable to find them. As witness Belair stated, "GameFly pieces are invisible due to their volume and anonymous design."[72] Witness Hodess acknowledged that GameFly made the business decision to change their return mail piece design from bright orange to white in 2005.[73]

Other reasons besides mail piece visibility would make GameFly mail pieces difficult to find. First, there are built-in culling mechanisms in the conveyor system that feeds the AFCS machines, which are designed to extract flat-shaped mail.[74] The mail handlers responsible for culling DVD mail in those operations may not be able to find GameFly mail pieces because they might already have

[72] USPS-T-2, page 8 at 15-16.
[73] Tr. 5/ 696.
[74] Docket 2001-1, USPS-T-22, page 29, lines 20-24.

been removed from the single-piece collection mail stream. Second, as witness Seanor indicated, it is not possible to isolate all DVD mail using these manual methods and this would especially be true for a relatively low volume mailer like GameFly.[75] Third, the ability to manually cull GameFly flat-shaped mail pieces is further complicated by the fact that GameFly relies on the BRM product such that its mail has to be processed through additional counting, rating and billing operations before it can be provided to the recipient. There is a lot of variation as to how BRM mail is processed in the field. The specific methods used at any one site are also largely dictated by volume and many lower volume BRM destinating sites have their operations structured to isolate the mail in incoming operations rather than outgoing operations.

c. None of the documents provided in discovery by the Postal Service constitute reliable evidence of record.

The CA Study, OIG Report, and other documents relied upon by GameFly should not be in the record because they have not been sponsored, authenticated or otherwise shown to be reliable. GameFly has alleged that many of the documents upon which it relies are admissible under the business records exception to the hearsay rule. Federal Rule of Evidence 803(6) requires a party to submit sponsoring testimony or a written certification that records are authentic. *See also* Fed. R. Evid. 901(a), 902(11). The hearsay exception for business records requires more than that the records exist within the files of a business. In order to be reliable and therefore meet the federal judiciary's

[75] USPS-T-3, page19 at 1-3.

procedural and evidentiary standards, a proponent must first show that the records were

> made at or near the time by, or from information transmitted by, a person with knowledge, if kept in the course of a regularly conducted business activity, and if it was the regular practice of that business activity to make the memorandum, report, record, or data compilation.

Fed. R. Evid. 803(6). No party has demonstrated, with particularity, that the CA Study, OIG Report, or any other document is a "business record" meeting these or comparable indicia of reliability. *E.g.*, *United States v. Lemire*, 720 F.2d 1327, 1350-51 (D.C. Cir. 1983); *Partido Revolucionario Dominicano (PRD) Seccional Metropolitana de Washington-DC, Maryland y Virginia v. Partido Revolucionario Dominicano, Seccional de Maryland y Virginia*, 311 F. Supp. 2d 14, 16-17 (D.D.C. 2004); *see also, United States v. Kim*, 595 F.2d 755, 761 (D.C. Cir. 1979) ("[Regarding hearsay, t]here is no place in scheme of the [Federal] Rules of Evidence for selective waiver of the requirements of particular exceptions."). Where a party fails to "establish[] that it was the 'regular practice' of [the sender's employer's] employees to write and maintain such emails," an email does not qualify as a business record for purposes of Federal Rule of Evidence 803(6). *State v. Microsoft Corp.*, 2002 WL 649951 at *1-*6 (D.D.C. 2002).

GameFly has alleged that some of the documents it relies upon are admissible as party admissions under the hearsay rule. To prove admissibility as an admission by a party opponent, a party must show that the statement was made by "a person authorized by the party to make a statement concerning the subject." Federal Rule of Evidence 801(d)(2). "The contents of the statement …

are not alone sufficient to establish the declarant's authority" to speak for the opponent. *See id*. The party seeking to admit the statement must show that the speaker had "the authority to take action about which the statements relate." *See Pappas v. Middle Earth Condominium Association*, 963 F.2d 534, 538 (2d Cir. 1992).

GameFly has not supported its argument that some documents produced by the Postal Service qualify as admissions by a party opponent. It merely makes the conclusory statement that documents are admissible under FRE 801(d)(2). It has not satisfied the requirements under FRE 801(d)(2) as described above, and in fact it has not analyzed any specific document for purposes of admissibility.

As explained above, because GameFly seeks to rely on the documents, it has the burden of demonstrating their admissibility, as well as their accuracy and reliability. These burdens have not been met.

B. GameFly's Reliance on Documents Obtained During Discovery Creates an Incomplete and Unreliable Record.

In attempting to establish an evidentiary foundation for its Complaint, GameFly has relied only to a very limited degree on testimony from competent experts or company officials. Rather, GameFly has primarily relied on a disparate collection of documents obtained from the Postal Service in discovery. From thousands of documents that the Postal Service produced, GameFly has selected a relatively few. From those, it has constructed legal arguments that cite the selected documents as support for its claims of unlawful discrimination.

GameFly's Memorandum presents these arguments and citations as the central element of its direct case.

As discussed above, the Postal Service believes that there are serious flaws in rulings that have approved the status of these unsponsored documents as evidence offered for the proof of their contents. Furthermore, the Postal Service has argued vigorously that GameFly's refusal to submit its interpretations and theories as testimony has denied the Postal Service the opportunity to challenge and test effectively GameFly's reliance on this unsponsored material. The Postal Service believes that GameFly's approach has seriously disadvantaged the Postal Service and denied it requisite due process to defend itself. As discussed above, the Postal Service believes that this approach is inconsistent with Commission rules and with prior Commission practice.

Beyond questions involving the evidentiary status of the documents on which GameFly relies, the Postal Service believes that there are serious problems with GameFly's approach. In particular, the Postal Service believes that there are significant flaws in the representativeness and quality of much of the information cited, and the accuracy with which GameFly interprets it. In this regard, the Postal Service submitted the testimony of Nicholas Barranca, a highly experienced official and former officer of the Postal Service, whose career spans decades of service in both operations and marketing. USPS-T-1. Mr. Barranca reviewed all of the documents that GameFly cites, and critiqued GameFly's methodology and usage. *Id.* at 16-22. Mr. Barranca concluded that "in choosing to avoid scrutiny of its own views by relying only on Postal Service selected

internal documents, rather than sponsoring its own testimony, GameFly has created a seriously deficient case to support its unfounded allegations of unlawful discrimination." *Id.* at 22.

In response, GameFly submitted the rebuttal testimony of Sander Glick. GFL-RT-1. Mr. Glick, however, did not seriously refute Mr. Barranca's analysis. His only reference to Mr. Barranca's critique of GameFly's reliance on unsponsored documents consisted of two citations to Mr. Barranca's testimony, in connection with Mr. Glick's contention that the Postal Service engaged in "quibbling over peripheral details" concerning the extent to which Netflix mail receives manual culling. *Id.* at 2-3. Mr. Glick did not discuss, let alone refute, the substance of Mr. Barranca's testimony in this regard. On cross-examination, GameFly engaged Mr. Barranca in questioning only to a limited degree, and did not ask about his testimony on GameFly's reliance on unsponsored material. At this stage, Mr. Barranca's testimony on this matter stands unrebutted.

Mr. Barranca's testimony advanced several reasons for questioning the representativeness, accuracy, and reliability of the citations in GameFly's Memorandum. While he reviewed all of the material, he gave only examples of the flaws in GameFly's approach. He noted in particular that GameFly relies on documents that are, among other deficiencies, stale, anonymous, undated, ambiguous, incomplete, fragmentary, internally inconsistent, and consisting mainly of unsponsored personal opinion. Mr. Barranca was especially critical of GameFly's tendency to misrepresent the pertinence of the documents to support GameFly's own conclusions and innuendos. *Id.* at 21.

The Postal Service has revisited Mr. Barranca's critique by conducting a more detailed analysis of the examples cited in his testimony. Attachment A, presents this analysis by discussing salient deficiencies in GameFly's citations. We have restricted this review to the documents Mr. Barranca used to illustrate the points in his testimony. Each statement Mr. Barranca makes in his testimony is restated verbatim, and each example document is discussed individually. A similar inquiry could be conducted involving all of the documents that GameFly cites in its Memorandum and testimony.

The extended analysis is highly instructive, since it permits closer scrutiny of GameFly's approach. While the Postal Service continues to assert its position that unsponsored documents do not merit evidentiary status, the exercise embodied in the Attachment relies on them to no greater degree than GameFly's Memorandum. In fact, the Attachment's objective is substantially more limited. Rather than extrapolate from, or interpret the documents to support legal theories with unfounded and unsponsored conclusions and innuendos, as GameFly has done, the Attachment focuses on the reliability of GameFly's methodology and the documents it cites.

C. GameFly's intentional choice to forego a litigation hold has made it impossible to develop a complete record.

It is a fundamental principle of litigation that, upon the initiation of litigation, the parties involved have the obligation to impose a litigation hold to avoid the destruction of documents relevant to the litigation. Parties that fail to impose a litigation hold, or even those that impose a litigation hold that proves ineffective, incur sanctions in the form of monetary penalties or negative inferences.

GameFly concedes that it chose not to impose a litigation hold on the advice of counsel. Tr. 5/914. The record is incomplete due to this failure on the part of GameFly.

In its answers to USPS/GFL-41, 43, 44, and 45, for example, GameFly states that "[any] other written or electronic communications relating to this issue were created long enough ago to have been deleted in the ordinary course of business pursuant to GameFly's document retention policies." In a later response, GameFly produced documents showing an April 30, 2009 effective date for its document retention policy. *See* Appendix USPS/GFL-63. Notably, this effective date occurred after the filing of GameFly's complaint on April 23, 2009; of logical necessity, the apperception that litigation could reasonably be anticipated arose well in advance of this date. As such, GameFly effectively confesses that it has engaged in spoliation of admissible evidence. In addition, the document retention policy applies only to email and instant messaging. It omits from its scope other documents, many of which the Postal Service requested in its document requests. *See*, *e.g.*, USPS/GFL-5 (requesting "documents and communications").

GameFly confirmed its fault in failing to protect responsive documents from destruction in its responses to oral cross-examination. Tr. 5/914. It also conceded its uncertainty regarding the volume of documents destroyed, and the relevance of those documents. *See* Tr. 5/918-919. GameFly's failure, through an intentional decision not to act, to impose an effective document retention policy has resulted in the irreversible loss of responsive documents and

communications that GameFly would otherwise have an obligation to produce. Accordingly, the Postal Service requests that the Commission impose sanctions against GameFly in the form of negative inferences drawn against GameFly where its failure to impose a litigation hold has created gaps in the record.

Conclusion

For the reasons set forth above, the Commission should deny GameFly the relief it seeks in its complaint.